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# THE VOLUNTARY CREDIT RESTRAINT PROGRAM -
# A NEW EXPERIMENT WITH AN OLD PROBLEM

by

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# CHAPTER I

## INTRODUCTION

Inflation is defined as a condition of general rising price levels. A more comprehensive definition, which points up the causal relationship behind inflation, states that inflation is present in a given economy when the general or aggregate demand for goods and services is greater than the general or aggregate supply of goods and services at the pre-existing price levels with the economy in the condition of general full employment. The result of the above situation is upward pressure upon price levels, since the demand value chasing the goods and services is greater than the supply value of those goods and services.

Another general causal analysis of inflation states that inflation will occur when planned investment exceeds planned saving, and with the qualification that the economy be at the full employment position. The outcome of the above condition will be a rising national income which will continue to increase until planned saving then comes into equilibrium with planned investment. In this case the result will not be a rise in real income or real output, since the economy is already producing its maximum product. But the inflationary gap and the disparity between planned saving and planned investment will be closed by rising price levels. This is a pseudo-increase in national income.

Actually, such cause-effect definitions do not present the true picture behind a condition of general hyper-inflation. The true meaning underlying inflation is inequity. It means inequity in the proper allocation of resources to the general welfare and common good. It means inequity in income distribution and economic hardship in resource allocation among the economic classes of the economy.

If each price, price level and cost in the economy increased on a pro rata basis, then, there would exist a state of inflation according to the first definition of inflation stated above. But because the inflation arose in the form of a proportional increase in all prices and costs, this condition does not accentuate the problem of income distribution inequity caused by the inflation, since none exists. Each income recipient--other factors remaining constant--has the same command over the same amount of goods and services as it had before the inflation occurred, hence there will be no increased inequity in income distribution stemming from this rise in price levels.

But in actuality, this problem of income distribution inequity caused by inflation does exist. It exists because certain groups in the economy have greater control over the determination of their incomes than do other groups in a period of severe upward spiraling prices. Because of this power held by certain economic classes in periods of inflation, these factions have the power of not only maintaining their position but also of increasing their position economically in the distribution of the national income at the expense of other groups which do not wield such power. Although the over-all economic pie has been absolutely growing in the long run and the relative shares have been increasing also in the long run, certain of the slices or portions of the pie going to the various economic classes of the economy in the short run have been either losing in their real share of the whole pie or else they have not been gaining at all in a real income sense. Hyper-inflation is a short run problem. A short run problem of economic inequity and hardship for certain classes could possibly lead to greater long run problems.

The numerous major and minor wars, from the Revolutionary War to the Korean War, in which the United States has been a principal participant, have been accompanied in the majority of cases by a strong inflation either during the war years themselves or in the post-war years of reconversion to peace. Although there have been mediocre attempts, never have these inflations been controlled to the satisfactions of the major proportion of the American working public, the primary economic group which suffers under spiraling price levels.

Thus the problem of inflation when it arises, is still a major future concern to the American public. The remedy to this problem may be in the greater intensive and profound application of our present economic tools of inflation control. Or it may be found in a stronger scrutiny of our knowledge and historical experiences with these anti-inflation mechanisms. And as equally important, the solution to this twentieth century "Gordian knot" may be found in new techniques, new approaches and new methods. The economic policy makers and enforcers of today and even the American people in general should not close their eyes, ears and minds to new means to this old problem of controlling inflation. They should be conscious of new tools and ideas designed to prevent the evils of inflation. Likewise, they should be willing to give these new methods of inflation control the empirical test. For empiricism seems to be the only true means of finding the worth of these new ideas and tools in the social sciences. This does not call for the economic policy that all new techniques along these lines should be hastily and thoughtlessly placed into the arena of economic reality for experimental purposes. This naiveté could possibly result in unexplored and earth-shaking economic problems greater than those presented by the inflation itself. Of course, common sense reasoning must be applied to these new methods before they can be risked in the realm of economic actuality. But after they have passed the common sense tests, fear and pressure on the part of special interest groups should not stand in the path of truly putting these new mechanisms to the "acid test" of the actual economic environment.

Lastly, the subjection of these new approaches and ideas to this empirical test also must be followed by proper evaluation of these new mechanisms concerning their correct economic policy significance. The very same groups which are willing to apply these new concepts to actual experimentation and who by doing this take upon themselves unforeseen risks also should be as willing to accept and abide by the conclusions and evaluations drawn from the experimentation. Failure to stand by the conclusions and evaluations as to the effectiveness of these new methods of inflation control regardless of whether the new tools prove to be feasible or non-feasible would nullify this avenue by which man can increase his knowledge and control over his social and economic environment.

Thus, it was with the Voluntary Credit Restraint Program which was put to the true test of experience from early 1951 to early 1952. Thus, it should be with the conclusions of that real-life experimentation concerning the effectiveness of the Voluntary Credit Restraint Program's approach to inflation control. The evaluation should stand and be recognized as wisdom from the economic past.

But first, Chapter II will point out the severity and breadth of the Korean inflation, beginning with the background of the recession of 1949 and concluding with the lull in the inflation pressures in early 1951. In Chapter III, the basic ramifications, nature and characteristics of the Voluntary Credit Restraint Program will be presented to the reader. Chapter IV will be a consideration of the basic mechanics of the VCRP in action. The last and most important of the main sections of this paper, Chapter V, is an attempt by the writer to point out various conditions found both in the general economic milieu and in the program as inherent characteristics per se which bear directly or indirectly upon the task of the program in fulfilling its aims.

Also, in the last chapter, there is an attempt by the writer to give an evaluation of the program in its actual encounter with the forces of inflation from March, 1951, to April, 1952.

# CHAPTER II

## KOREAN INFLATION, JUNE, 1950 - FEBRUARY, 1951

### 1. Introduction: Recession of 1949

In order to present a clear and understandable discussion of any given period of economic history - whether the period is rather recent or more distant in the chain of historical happenings makes no difference - a preview of some of the economic conditions prior to this period will help to throw some light upon the subject that will be analyzed later.

In 1949, the American economy experienced what has now been properly labeled as an inventory recession. This type of economic slump can prove to be dangerous or merely a normal retrenchment of the economic position with a healthy flexion of the economy's business muscles. Whether the former or the latter will result depends upon the other economic forces at play during this readjustment. Actually for the American economy as a whole, the realignment of retail, wholesale and manufacturing stocks did not thrust upon us a major economic crisis with mal-reverberations that would have been heard and felt in all sectors of the commercial, productive and financial structure of the business economy.

The reason for the absence of a major crisis, although the gross national product fell by only .8 billion dollars from 259.0 billion dollars in 1948 to 258.2 billion dollars in 1949 and at the same time failed to achieve its historical 3 percent rate of growth by 9.6 billion dollars, was because personal consumption expenditures continued to increase from 177.9 billion dollars in 1948 to 180.6 billion dollars in 1949, and total Federal, State and local government purchases of goods and services increased by 7 billion dollars from 36.6 billion dollars in 1948 to 43.6 billion dollars in 1949. This increase in personal consumption expenditures and government purchases of goods and services of 9.7 billion dollars was enough to offset the decline in gross private domestic investment of 9.2 billion dollars from the 1948 level of 42.7 billion dollars to the 1949 mark of 33.5 billion dollars.

But in analyzing the components of gross private domestic investment, it is found that the greatest decline occurred, not in new construction or producers' durable equipment expenditures, which fell by only 1.7 billion dollars, but in the net changes in business inventories which had a positive 5 billion dollar change in 1948 and a negative 2.5 billion dollar change in 1949 for a total net change of a minus 7.5 billion dollars. Thus, the recession of 1949 can be accurately called an inventory phenomenon.[1] (The data presented are not completely accurate because of rounding.) Wholesale prices, (1947-49=100), all commodities, declined

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[1]The Economic Report of the President, January, 1953, p. 165, (Hereinafter referred to as "Economic Report").

5.2 percentage points from 104.4 in 1948 to 99.2 in 1949. Consumers' price index, (1935-39=100), all items, fell only 1.7 percentage points from 171.9 in 1948 to 170.2 in 1949.[2]

Total national income for 1948 was 223.5 billion dollars. In 1949, it had fallen by 7.2 billion dollars to 216.3 billion dollars not considering the changes in price levels as pointed out above. But during this period, employees' compensation, that is wage and salary receipts and other labor income, plus employer and employee contributions to social insurance, declined by only .3 billion from 140.2 billion dollars in 1948 to 139.9 billion in 1949. Corporate income before taxes, declined by 6.7 billion. Income of unincorporated enterprises fell by only 1.5 billion dollars.[3] Certain minor fluctuations have been omitted.

Personal income declined in 1949 from the previous post-World War II high of 209.5 billion dollars in 1948 to 205.9 billion dollars. Personal tax payments did not decrease appreciably during this period. Personal disposable income declined from 188.4 billion dollars in 1948 to 187.2 billion dollars in 1949, a drop of only 1.2 billion dollars; and yet, in this same time period, personal consumption expenditures, that is, personal income less personal taxes and personal net saving, increased from 177.9 billion dollars in 1948 to 180.6 billion dollars in 1949. This was a net

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[2]Economic Report, January, 1953, pp. 188, 190.

[3]Ibid., p. 171.

increase of 2.7 billion dollars in spite of the decline in personal income and small declines in personal taxes. The answer to this increase in consumption is found in the fact that net personal saving decreased from 10.5 billion dollars in 1948 to 6.7 billion dollars in 1949. As a percentage of disposable personal income, personal net saving declined from 5.6 percent to 3.6 percent from 1948 to 1949, or a percentage decline of 36 percent from 1948 to 1949.[4]

Also during this period, 1948-1949, unemployment, which had been declining from the post-World War II high of 2,270,000 unemployed in 1946, or stated in another way 3.9 percent of the total civilian labor force, began to rise in 1949. In 1948, unemployment as a percentage of the total civilian labor force was 3.4 percent or 2,064,000 unemployed out of a total civilian labor force of 61,442,000. In 1949, the ratio of unemployment to the total civilian labor force had risen to 5.5 percent or 3,395,000 unemployed out of a total civilian labor force of 62,105,000.[5]

From these few economic indicators, it can be seen that the economic readjustment in 1949 was truly an inventory fluctuation in the private business sector. Personal consumption expenditures actually increased in the face of declining personal income and increasing unemployment. The increase in personal expenditures was found in durable goods,

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[4] Economic Report, January, 1953, p. 174.

[5] Ibid., p. 177.

especially automobiles and parts, and services whereas non-durable goods expenditures declined. Government purchases of goods and services was another of the strong sustaining factors that offset the decline in gross private business investment and prevented the declining business investment outlays, especially in inventories, from playing havoc with the economy. Also it was found further that the decline in the business sector's purchases of goods and services was mainly confined to a fall in inventory accumulation; whereas, the other areas of private investment declined by only 1.7 billion dollars.

The question which interested most economists at this time was whether the recovery from this inventory recession was well under way before the outbreak in Korea, or whether the impacts of the exogenous factors brought on by the Korean War were the primary forces in bringing about recovery from this economic setback.

### 2. First Phase: Recovery from 1949

According to the President's Council of Economic Advisers, "The economic history of 1950 divides into three distinct parts: the period of recovery from the recession of 1949; the period of expansion of the defense program following the Korean outbreak on June 25; and the more intense period following the beginning of major Chinese hostilities in late November."[6]

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[6] Economic Report, January, 1951, pp. 33-34.

The recovery from the recession of 1949, according to the Council of Economic Advisers, began in August of 1949. Hesitant business activity grew more vigorous and sustained an upward trend in early 1950. Industrial production increased more than 10 percent from February to June, 1950. Employment followed a similar course. Of the 4.7 million unemployed in February, 1950, one-fourth had jobs by June. Personal incomes, enlarged by the veterans' insurance refund of 2.6 billion dollars, as seen in Chart 1, and increasing wage payments fed a growing volume of consumer expenditures. Personal consumption expenditures increased from the 1949 annual rate of 180.6 billion dollars to the seasonally adjusted annual rate of 187.1 billion dollars in the first half of 1950.[7] Average gross hourly earnings in selected industries were up $0.05 by June, 1950. Average gross weekly earnings in selected industries were up almost $4.00 from 1949 to June, 1950.[8] Residential construction starts, which declined less than seasonally in winter, sprang upward in March to new heights at an unprecedented pace by the second quarter. Investment in plant and equipment, after a decline in the first quarter, expanded greatly by the second quarter as seen in Chart 9.[9]

The Council of Economic Advisers stated:

> This rising level of business activity in the early months of 1950 was not based upon transitory causes which

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[7]*Economic Report*, January, 1953, p. 169.

[8]*Ibid.*, pp. 180-181.

[9]*Economic Report*, January, 1951, *loc. cit.*

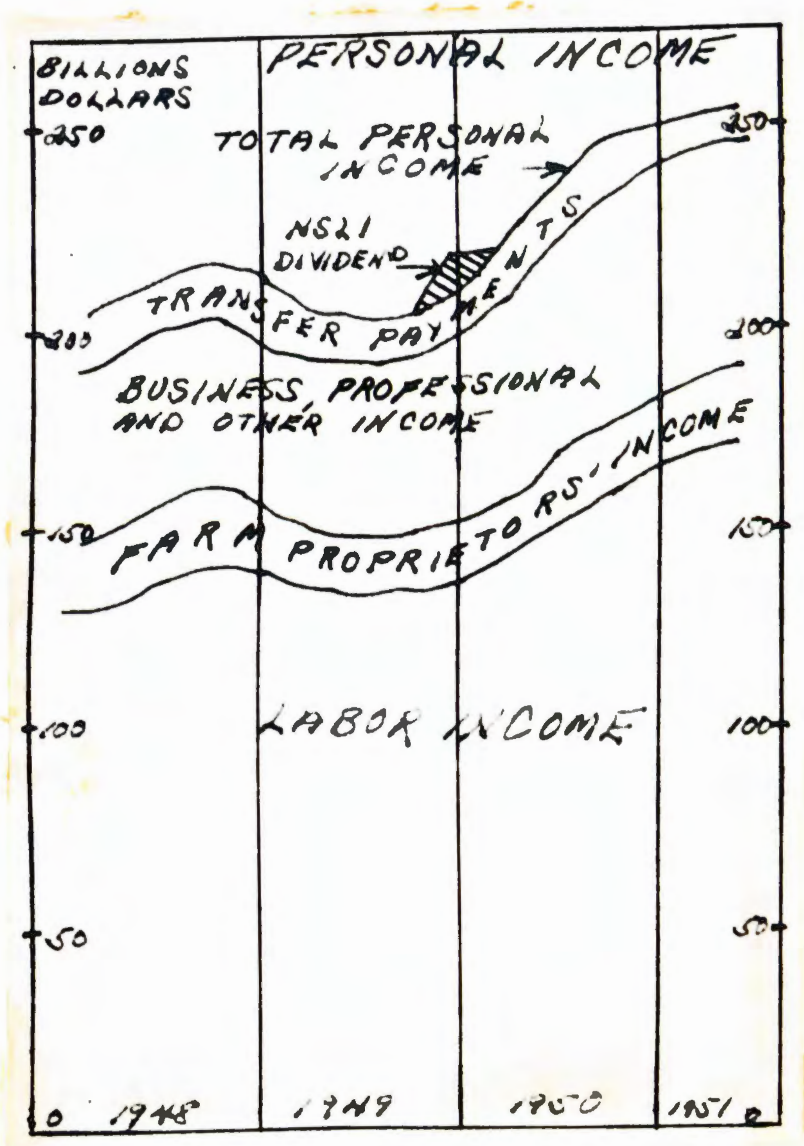


Chart 1. Personal Income
Source: Economic Report, Midyear, 1951.

might have been expected to terminate expansion toward midyear. The payment of the veterans' dividend which some observers overstressed, contributed to the recovery, but was not the basic factor in recovery. Nor did the upward movement have the ephemeral quality of an inventory boom. Producers and merchants were cautious about accepting the bounding market as a firm foundation for a reversal of their inventory policies. Manufacturing inventories (seasonally adjusted) did not exceed the September, 1949, level until May, 1950, and the increase in value from January to June was 3 percent. The increase in value of retail inventories during the same period was 5 percent. In both cases, inventories were expanding less rapidly than sales.[10]

Rising prices have often accompanied business recovery, and thus, the moderate upward trends at this time were not viewed with alarm in the first half of 1950. Wholesale prices (1926=100), all commodities, rose from 151.4 in January, 1950, to 157.3 in the last week of June, 1950, representing a 4 percent increase for the period. The index of industrial prices rose by only 3 percent. The consumers' price index, (1935-39=100), all items, in January, 1950, was 168.2 by June, 1950, it had risen to only 170.2 or less than a 2 percent increase over the January, 1950, figure.[11]

Bank credit and monetary expansion, which was interrupted in 1948 and the first half of 1949, began to increase in the 12 months ending June, 1950. "....It is estimated that privately-held deposits and currency amounted to about 170 billion dollars on June 30, a new peak for that date, and about 4.5 billion dollars more than a year earlier....."[12]

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[10] Economic Report, January, 1951, pp. 33-34.

[11] Economic Indicators, March, 1951, p. 3.

[12] "Resumption of Bank Credit and Monetary Expansion." Federal Reserve Bulletin, 36:771, July, 1950.

See Chart 5. This expansion resulted primarily from a mounting volume of real estate and consumer loans, together with sustained bank investment in State and local government securities. The expansion in credit in the 12 months ending in June, 1950 greatly accounted for and propelled business recovery. But this was mainly confined to the consumer credit area and real estate loans. From June, 1949, to June, 1950, consumer credit extended by all lenders had increased roughly from 14 billion dollars to 17.5 billion or about 3.5 billion dollars, resulting in an increase of about 25 percent.[13] See Chart 10.

Business loans at commercial banks, which had been fluctuating since 1947, declined much more than the usual seasonal amount in the first half of 1949.

> Since mid-1949 business loans have recovered part of the decline of the first half of that year..... Demand for business loans continued strong in the first six months of 1950. As business activity has accelerated in recent months, businesses generally have made substantial seasonal additions to inventories and customer receivables, a portion of which is ordinarily financed by bank loans. They have also maintained their plant and equipment expenditures at levels only slightly lower than last year.....[14]

After two years of little change at high levels, the volume of deposits and currency held by business and individuals increased by about 4.5 billion dollars during the 12 months ending June, 1950, to a new peak level for the mid-year. The expansion was very substantial compared with that in the two preceding 12 month periods as seen in Chart 2.

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[13] Ibid., p. 773.

[14] Ibid., p. 774.

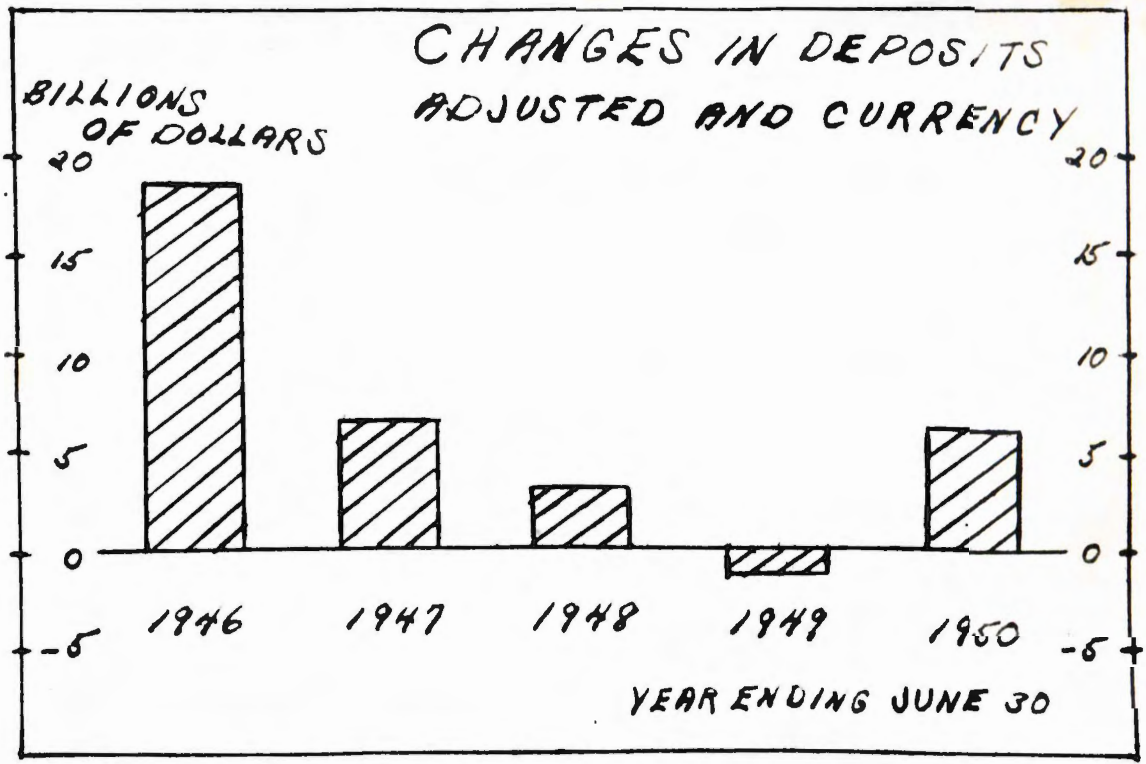


Chart 2. Changes in Deposits Adjusted and Currency.
Source: Federal Reserve Bulletin.

Holdings of United States Government securities by the banking system (Federal Reserve, commercial and mutual savings banks) declined substantially in the first four months of 1950, but increased in May and June. Strong cash positions of corporations and others, combined with increased yields and resumption of bond sales by the Federal Reserve System, found the basis for a shift in Government securities to non-bank investors in early 1950.[15]

The principal force propelling the growth in the

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[15] *Ibid.*, p. 775.

privately-owned money supply in the 12 months ending June, 1950, was the enhancement in the volume of bank credit, especially to borrowers other than the government. Treasury operations, that is, including changes in Treasury deposits with the banking system and new financing, had only a small contractive effect over this period as a whole. A small gold outflow also tended to contract the privately-held money supply.[16]

The increase in privately-held deposits in the 12-month period under consideration here was accompanied also by an increase in the rate of demand deposit turnover. The increase in the turnover rate of demand deposits began in the last half of 1949 after declining since 1948 for other leading cities and early 1949 for New York City. "....This higher rate of money use combined with a large money supply reflects a larger volume of expenditures than in any earlier comparable period...."[17]

The industrial production index, (1935-39=100), all industries, in 1948 was 192--in 1949 it had fallen to 176. Then, for the seasonally adjusted annual rate for June, 1950, it rose to 199.[18] These economic data definitely indicate that recovery from the inventory recession of 1949 was well under way before the outbreak of hostilities on June 25, 1950.

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[16] Ibid., p. 776.

[17] Ibid., p. 777.

[18] Economic Report, January, 1953, p. 182.

This is not to say that the increased prosperity that was evident in early 1950 would have continued without the help of the exogenous impetus of the Korean conflict, but it can be concluded from the evidence shown here that recovery had been started.

Thus, with the increase of the industrial production index to new heights, combined with the rise in consumer expenditures, the total consumer credit outstanding, decrease in unemployment, and the expansion in the money supply and business investment in plant and equipment and inventories at increasing levels plus the fact that bank deposits were increasing along with an increase in the rate of turnover of these deposits and with the wholesale and consumer price indexes increasing at a moderate but not alarming rate; with all these economic indicators pointing to recovery, the only conclusion that could be supported was that recovery was well underway before invasion of South Korea from the North.

### 3. Second Phase: Korean Impact

With the invasion of the Republic of South Korea by the North Korean Communist puppet government, the impact of inflation from this international political conflict was felt not only in the United States, but by repercussions and time lags throughout a large portion of the world. The event thus opened the second phase of the economic history of 1950 as set out by the Council of Economic Advisers in the citation above. This second period joined by the third period, has since become the second great era of inflation since the depression of the nineteen-thirties.

There were two basic causes for the strong inflation climate at that time. First, the psychological causes will be considered. At that time, the economic psychology was divided into two camps. On the one hand, there were the numerous consumers who remembered the shortages of consumer goods during the Second World War, the hard-to-get automobiles and automotive parts, the rationing of foods, shoes, gasoline et cetera, and the complete absence of many other items from the markets. The hard-hit consumers of the last great military conflict had learned a lesson they had not forgotten. Thus, consumer expenditures began to expand rapidly.

The other economic-psychological outlook was that of the businessmen. Their quest for profits led them to large-scale inventory accumulation which in turn was followed later by increased business investment in capital equipment. These two group outlooks were enough to create a general over-all demand that could not be met by the general supply. This economic condition of course meant inflation.

The second basic cause for the tremendous burst of inflationary pressures was the fact that the economy was already coming out of the recession of 1949 and was well on the road to recovery. In the words of the Council of Economic Advisers, "The shock of the initial involvement in Korea fell upon an economy which was experiencing a high level of prosperity, with few slack resources or signs that the boom forces were leveling off....."[19] That is to say, a boom was being superimposed upon a growing recovery or a potential boom.

After the Korean outbreak, many economic indicators accurately pointed up the inflationary effect of the sudden open hostilities on the Korean peninsula.

Prices. The wholesale price index, (1947-49=100), all commodities, which had risen less than two points from a January, 1950, position of 97.7 to a May level of 99.6, in June was resting at 100.2. By November, 1950, before the entrance into the third phase of the inflation it had shot up to 109.3. This was almost a 2 point increase per month. From Table I and especially Chart 3 of wholesale prices, this can be seen more vividly.

TABLE I

WHOLESALE PRICES, ALL COMMODITIES
(1947-49=100)

| Month | 1950 | 1951 | 1952 |
|---|---|---|---|
| January | 97.7 | 115.0 | 113.0 |
| February | 98.3 | 116.5 | 112.5 |
| March | 98.5 | 116.5 | 112.3 |
| April | 98.5 | 116.3 | 111.8 |
| May | 99.6 | 115.9 | 111.6 |
| June | 100.2 | 115.1 | 111.2 |
| July | 103.0 | 114.2 | 111.8 |
| August | 105.2 | 113.7 | 112.2 |
| September | 107.1 | 113.4 | 111.8 |
| October | 107.7 | 113.7 | 111.1 |
| November | 109.3 | 113.6 | 110.7 |
| December | 112.1 | 113.5 | 109.6 |

Source: Federal Reserve Bulletin

[19] Economic Report, January, 1951, pp. 34-35.

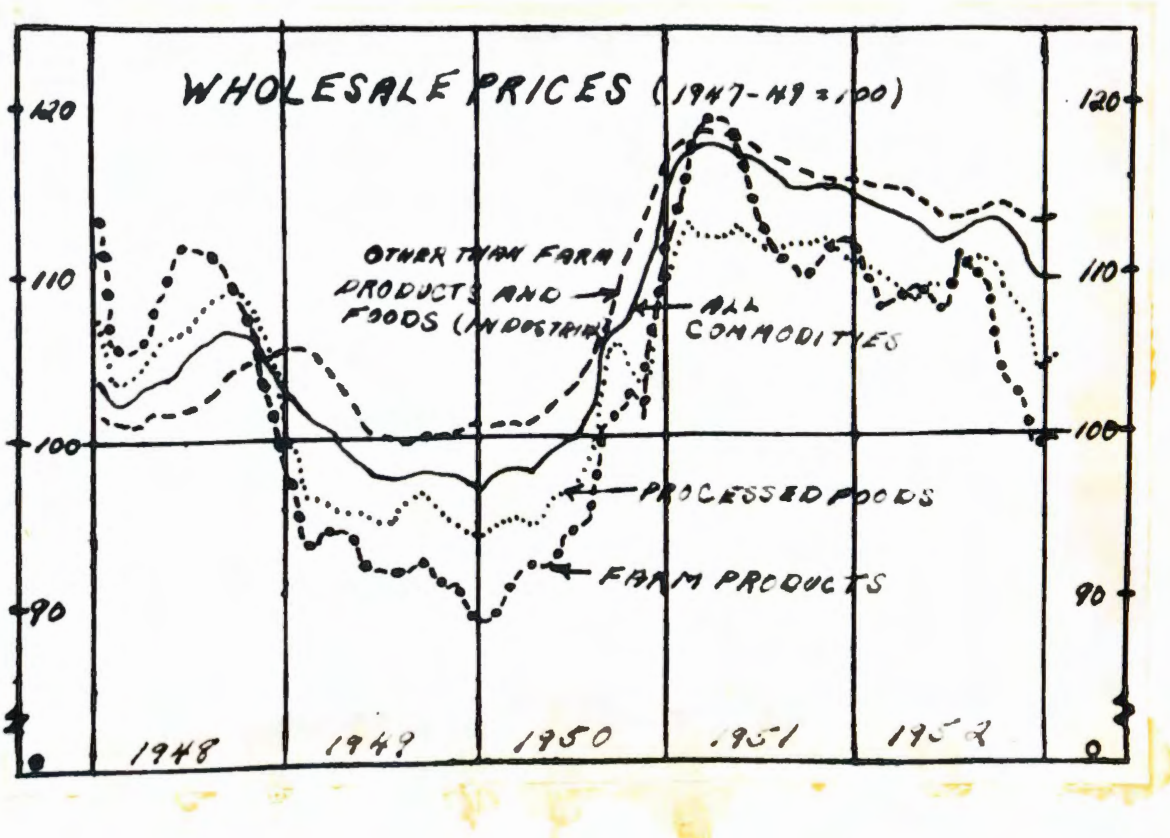


Chart 3. Wholesale Prices.
Source: Economic Indicators.

TABLE II

WHOLESALE PRICES, SELECTED COMMODITIES
(1947-49=100)

| Group | June 1950 | Nov. 1950 | Feb. 1951 |
|---|---|---|---|
| Farm Products | 94.5 | 104.2 | 117.2 |
| Processed Foods | 96.8 | 103.5 | 112.9 |
| Textile Products & Apparel | 93.3 | 109.1 | 115.7 |
| Hides, Skins & Leather | 99.1 | 116.6 | 127.7 |
| Fuel, Power & Lighting | 102.4 | 105.4 | 107.4 |
| Chemicals & Allied Prods. | 92.1 | 103.4 | 112.6 |
| Rubber and Products | 109.5 | 149.2 | 152.5 |
| Lumber & Wood Prods. | 112.4 | 122.7 | 126.4 |
| Metal & Metal Prods. | 108.8 | 117.7 | 123.7 |
| Machinery & Motive Prods. | 106.3 | 112.8 | 117.7 |
| Nonmetallic Minerals | 105.4 | 110.7 | 113.7 |

Source: Federal Reserve Bulletin

From the index of selected commodities, the wholesale picture can be viewed more precisely. The manufacturing raw material supplies led the group with rubber and products in the lead followed by chemicals, lumber, metal and metal products, machinery and nonmetallic structural minerals.

The consumers' price index, (1935-39=100), all items, showed a similar pattern of movement though not as pronounced as the wholesale price index. In January, 1950, the index was steady at 168.2 and in May had risen to only 169.3 and in June to 170.2, but by November, 1950, it had jumped 6.2 points to a high of 176.4 percent.

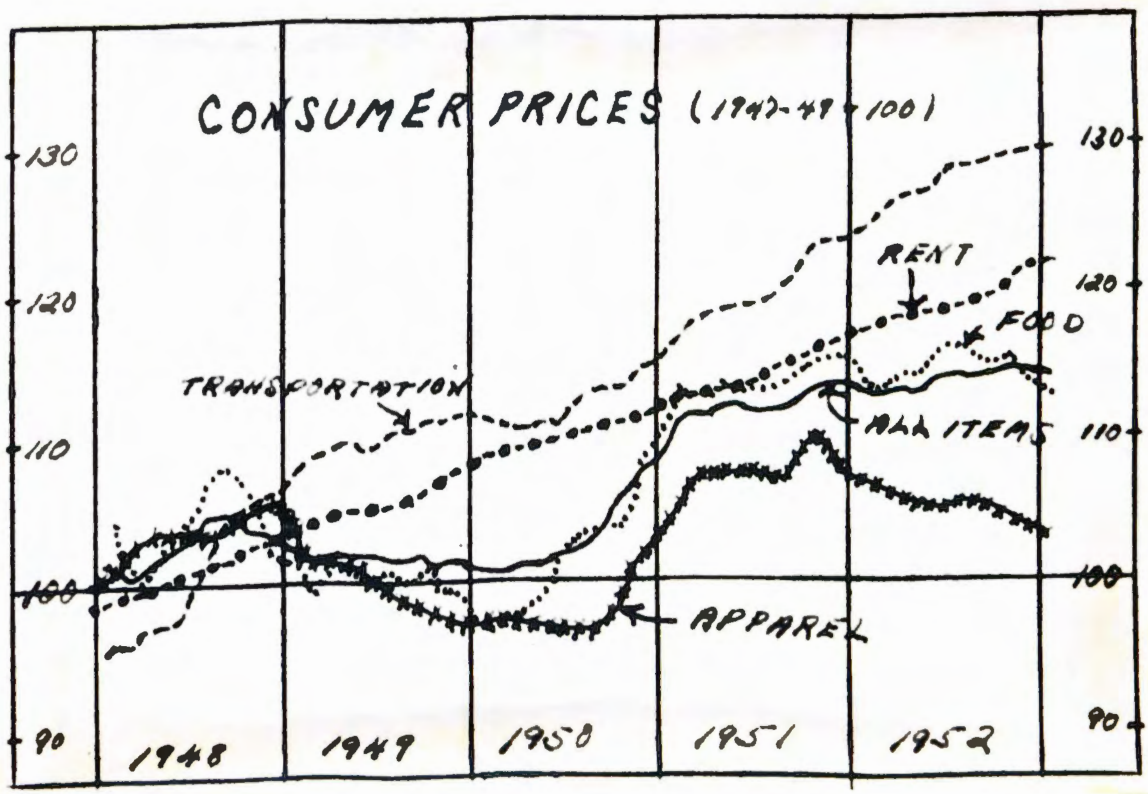


Chart 4. Consumer Prices.
Source: Economic Indicators.

TABLE III

CONSUMER PRICES, ALL ITEMS
(1935-39=100)

| Month | 1950 | 1951 | 1952 |
|---|---|---|---|
| January | 168.2 | 181.5 | 189.1 |
| February | 167.9 | 183.8 | 187.9 |
| March | 168.4 | 184.5 | 188.0 |
| April | 168.5 | 184.6 | 188.7 |
| May | 169.3 | 185.4 | 189.0 |
| June | 170.2 | 185.2 | 189.6 |
| July | 172.0 | 185.5 | 190.8 |
| August | 173.4 | 185.5 | 191.1 |
| September | 174.6 | 186.6 | 190.8 |
| October | 175.6 | 187.4 | 190.9 |
| November | 176.4 | 188.6 | 191.1 |
| December | 178.8 | 189.1 | 190.7 |

Source: Economic Indicators

TABLE IV

CONSUMER PRICES, SELECTED ITEMS
(1935-39=100)

| Items | June 15, 1950 | Nov. 15, 1950 | Feb. 15, 1951 |
|---|---|---|---|
| Food | 203.1 | 210.8 | 226.0 |
| Apparel | 184.6 | 194.3 | 202.0 |
| Rent | 130.9 | 132.5 | 134.0 |
| Fuel, Electricity & Refrigeration | 139.1 | 142.5 | 143.9 |
| House furnishings | 184.8 | 201.1 | 209.7 |

Source: <u>Federal Reserve Bulletin</u>

The wholesale price index had increased by roughly 9 percent from June to November, 1950. The consumers' price index had advanced by approximately 4 percent in this identical time period. The explanation is rather simple. Strong consumer scare buying although supplies were plentiful; the rush to stockpile raw materials by businessmen, especially those which would be needed in the defense effort upon which foreign suppliers and importers had to be relied for procurement; and business profiteering in the consumer market, were some of the factors. The rise in prices of products going into the military program had eaten up almost the entire 4.5 billion dollars in new taxes just voted by Congress before they could be collected.[20]

The average market cost of 28 basic commodities jumped 21 percent between June 23, the week before the attack, and the end of August. Farm products and foods were up 8 percent, industrial commodities, 5 percent. The heaviest price pressure was upon raw materials. Since April, copper had risen 27 percent; lead 52 percent; steel scrap 58 percent; zinc 62 percent; cotton cloth 50 percent; rubber 80 percent; wool 45 percent; lumber 15 percent and thus the story went.[21]

Durable goods prices took the same route, especially in automobiles and parts, furniture and household appliances. The price indicators clearly point up the severity of the

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[20] "Galloping Inflation." New Republic, 123:5-6, October 2, 1950.

[21] Ibid.

Korean inflation from June to November, 1950.

Agricultural Position. During the first half of July, prices of farm products rose 7 percent. Income of farm proprietors since June had averaged about one-eighth higher than in the same period last year, but about one-fourth below the record level for the year, 1948. From mid-July to the latter part of August, buying interest in domestic foodstuffs receded mainly because of large and increasing market supplies plus huge carry-overs which were released onto the markets, plus indications of the imposition of curbs on inflation by legislative action. But in the last week of August when the prospect for the immediate promulgation of direct controls vanished, wholesale prices of foods and farm products advanced again. At the end of August, prices of farm products were 8 percent above June and 16 percent above the low at the beginning of the year.[22] "The farm price support program has had diverse effects on prices in recent months. While purchases of some products, particularly eggs and dairy products, have been a factor in maintaining prices, releases of other products have limited price advances."[23] The price increases reflected increased demands for farm products due to increased incomes of consumers and expansion in employment. They were not a reflection of reduced crop production and seasonal decreases in livestock marketings.

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[22] "Recent Developments in Agriculture." Federal Reserve Bulletin, 36:1099, September, 1950.

[23] Ibid.

According to the index of prices received and paid by farmers for goods and services and the parity ratio index, (1910-14=100), in June, 1950, the index of prices received by farmers was 247, while the parity index of prices paid by farmers was 254 giving a parity ratio of 97; but by January, 1951, the farmers' prices received index was 300 and the index of prices paid was 272 giving a parity ratio of 110. This indicated an improvement of the farm income position from June, 1950--provided one can rely upon indexes and statistical methods for presenting a true picture of the economic situation.[24]

Monetary and Credit Developments. The money supply and credit outstanding, which for most purposes serve the same function in the economy, are of course important tools of economic control. At the same time they are excellent indicators of economic activity. The great and more immediate inflationary impact of the Korea incident arose from the rapid increase in expenditures of businesses and consumers in anticipation of shortages of civilian goods and of advances in prices. The rise in the money supply and credit, was well under way prior to June, 1950. See Chart 5.

Bank credit continued to expand in the third quarter of 1950. Commercial banks increased their total loans by an estimated 4 billion dollars in the third quarter and their holdings of state and local government and corporate securities by about 800 million dollars. In the four-month period,

[24]*Economic Report*, January, 1952, p. 190.

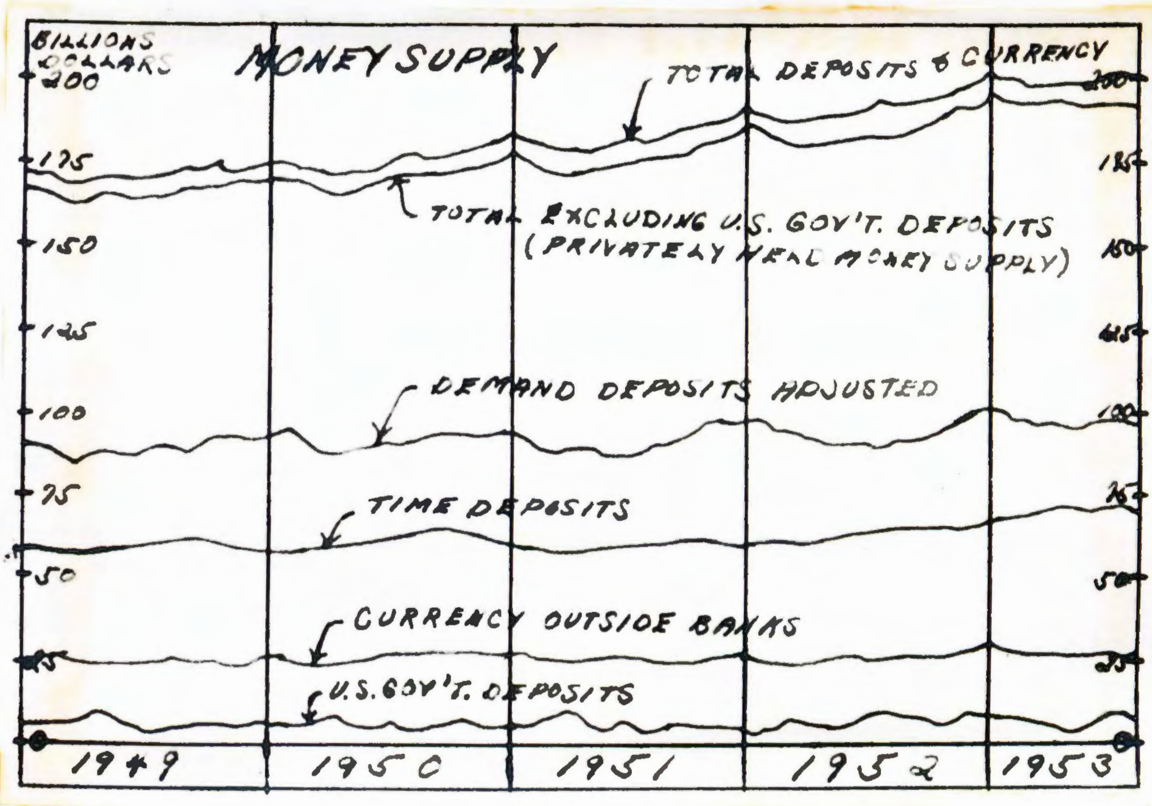


Chart 5. Money Supply
Source: Economic Indicators.

July to October, the loans of all commercial banks increased more than 5 billion dollars or 11 percent. See Chart 6.

> The expansion since June in credit to private borrowers and to state and local governments, which has been in part seasonal, has exceeded that in any peacetime period of similar length. Much of the recent sharp expansion in loans reflects commitments made before restrictive credit policies began to be imposed. Some of the expansion may have reflected anticipation of future needs.[25]

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[25] "Recent Monetary and Credit Developments." Federal Reserve Bulletin, 36:1276, October, 1950.

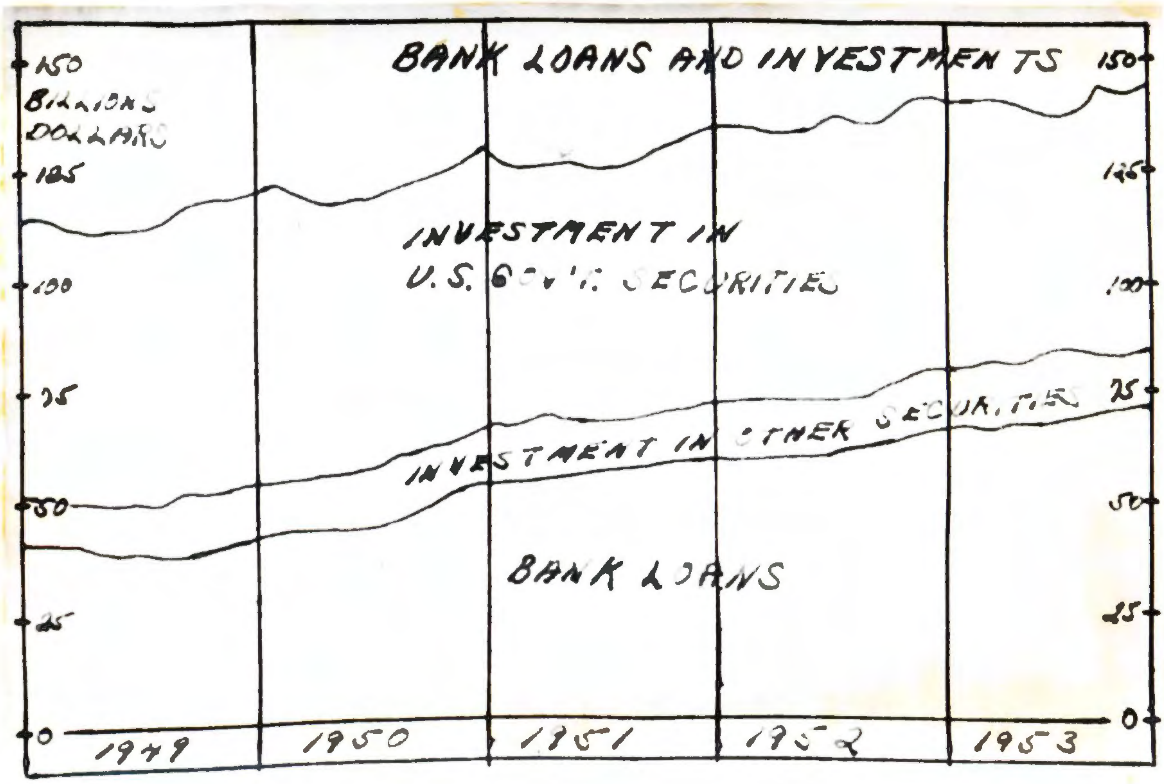


Chart 6. Bank Loans and Investments
Source: Economic Indicators.

Businesses were great borrowers in the third quarter. The great surge for credit was due to anticipated shortages of materials and increased prices. Inflation was feeding on inflation. Bank loans to businesses accounted for more than half of the over-all loan expansion in this quarter, greater than the same period in 1946. Credit extended by banks and other lending groups to purchasers of houses was a large factor in the recent expansion of private credit. New loans on small residential properties during the first few months of 1950 were estimated at slightly less than 11 billion dollars or an annual rate of almost 14.5 billion compared with roughly 11 billion dollars in each of the past three years. Reflecting a more rapid expansion in new debt than in repayment of previously contracted loans, mortgage debt outstanding on 1-4 family homes increased nearly 2 billion dollars in the third quarter compared with an increase of less than 4 billion dollars during the entire year, 1949. Loans of commercial banks on homes and other real estate increased during this three-month period by about .9 billion dollars which was about as much as in the preceding six months.

Consumer buying had advanced even before Korea. After June, 1950, consumer installment credit increased more sharply. The expansion of about 1,200 million dollars in the third quarter compared with 800 million dollars in the same period of 1949 and the amount outstanding at the end of September exceeded 13,000 million dollars, about one-third above the level 12 months earlier. Consumer loans by commercial banks increased about 900 million dollars in the third quarter, thus matching the growth during the entire last half of 1949.

Banks had also increased substantially their investments in corporate, state and local government securities during this period. Commercial bank portfolios of these securities increased by an estimated 800 million dollars, which was equal to the increase in the first half of the year. The bulk of the purchases were state and local obligations.

The money supply increased in the third quarter by more than 2 billion dollars, and "....this rapid rate of increase almost equaled that of the third quarter of 1947 - a period of substantial inflation."[26] But calculated on a June 30 to November 29, 1950, basis, the increase was somewhat greater. The money supply,[27] that is, currency outside the banks, adjusted demand deposits, government balances at the Federal Reserve and commercial banks, Treasury cash and foreign deposits at commercial banks, on June 30, 1950, was 118.8 billion dollars. On November 29, 1950, it had increased to 122.3 billion dollars or an approximate increase of 3.5 billion dollars. The most influential factors responsible for this increase in the money supply were increased loans, both total commercial and industrial loans. These had increased approximately 6.7 billion dollars but this was offset by a decrease in total investments of 3.1 billion dollars. The greatest decrease in investments was in U.S. Government obligations which declined by 4.1 billion dollars. Corporate, state and local obligations held by the commercial banks increased, by roughly .9 billion dollars. Adjusted demand deposits increased from 85.0 billion dollars to 90.3 billion or an increase of 5.3 billion due to commercial and industrial loans. Government deposits at commercial and Federal Reserve banks declined by 1.3 billion dollars. The other determinants of the money supply

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[26] _Ibid_., p. 1277.

[27] Note, the money supply calculated by this formula differs from the money supply used by the Federal Reserve System's publications because in this formula time deposits are not included.

remained relatively stable.[28]

After rising almost steadily during the first half of the year, the turnover of demand deposits at banks in leading cities outside New York, accelerated during the third quarter. In that period, deposits were more active than in the corresponding quarters of any postwar year.

Because of the strong demand found at that time in the money markets, short term money rates tended to stiffen during most of that year, reflecting growing credit demands. This was modified somewhat by the Federal Reserve policy of purchasing short term securities. But rates on three-month bills, which were about 1.10 percent at the end of 1949, rose to 1.17 percent by June, 1950, while the one-year rate rose from 1.10 to 1.23 percent. In the latter part of August and early September, yields on short-term securities increased by about 1/8 of 1 percent. Yields on new Treasury bills were at 1.32 percent by September and on securities with one year to maturity about 1.35 percent. Long term treasury bonds were at extremely low levels at the end of 1949 but increased in the first half of 1950 by about 1/8 of 1 percent.[29]

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[28]A balance of the determinants of the money supply given here is impossible because of rounding and the non-consideration of other factors which were not too dynamic during this period.

[29]"Recent Monetary and Credit Developments." Federal Reserve Bulletin, 36:1280, October, 1950.

Personal Consumption Expenditures, Saving and Installment Credit. Personal consumption expenditures rose by around 7 percent from the second quarter level of 188.7 billion dollars to the third quarter annual rate of 202.5 billion dollars. This was the greatest quarter-to-quarter increase in a decade.[30] Consumer purchases of durable goods, mainly in automobiles, automotive parts, household furnishings and durable appliances, increased about 25 percent. This demand occurred at a time when the industries producing these goods were operating at production peaks with rising price levels. After the consumer buying spree in July and August, consumer expenditures declined but were still larger in relation to the previous year. Automobile workers' wage increases set the stage for further labor demands which spread rapidly, resulting in increased personal incomes and expenditures. Also, longer working hours and increased employment led to increased expenditures. "In 1950, the expansion of consumer installment credit outstanding accelerated. The increase of 2.4 billion dollars in the first nine months was larger than that for any full postwar year."[31]

Another factor which led to increased consumer expenditures was that of consumer dis-saving. One source pointed out:

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[30] "Recent Developments in Installment Credit." Federal Reserve Bulletin, 36:1427-36, November, 1950.

[31] Ibid.

One factor in the recent increase in spending has been the reduction in certain types of liquid asset holdings of individuals. During the third quarter, time deposits at commercial and mutual savings banks declined by approximately one-half billion dollars, redemptions of savings bonds exceeded purchases by about one-third billion, and share-holdings at savings and loan associations were also drawn down. In the same period of last year savings deposits showed little change, while purchases of saving bonds exceeded redemptions, and share-holdings at saving and loan associations showed a substantial increase. In recent weeks, however, there has been some slackening in the reduction of total liquid asset holdings by individuals.[32]

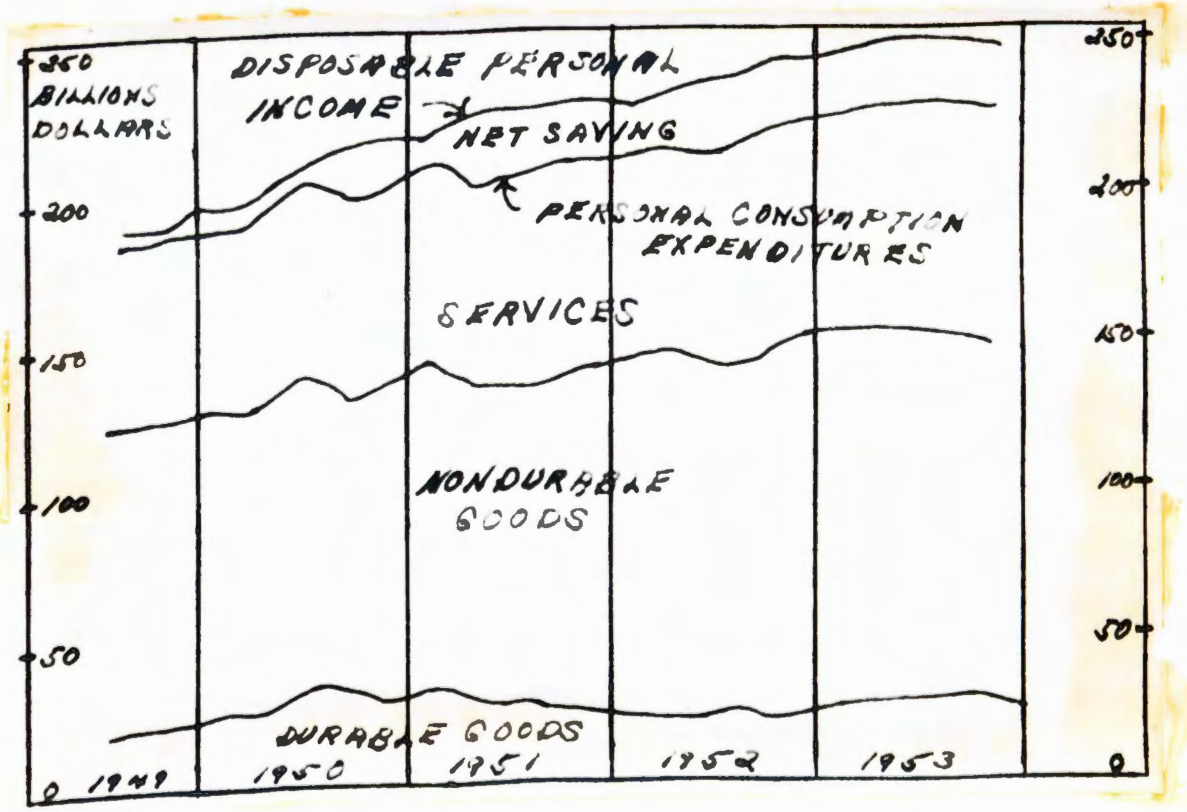


Chart 7. Consumer Income, Spending and Saving.
Source: Economic Indicators.

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[32]"Recent Monetary and Credit Developments." Federal Reserve Bulletin, 36:1278, October, 1950.

A striking development in 1950 was that in the third quarter expenditures for private new construction, producers' durable equipment and consumer durables accounted for more than 29 percent of the total national product. But, Federal Government purchases of goods and services were only 7.5 percent of that total, the smallest proportion since early in 1948. Outlays for private investment were the major factors in the expansion of 1950, along with consumer demand.

Personal saving as defined in the national income and product accounts, that is, personal disposable income less personal consumption expenditures, decreased in the third quarter 1950 both in dollar amount and as a percentage of disposable income. From an article in the Federal Reserve Bulletin, it was pointed out that:

> With disposable income in the first quarter of 1950 swollen by payments of National Service Life Insurance dividends and with consumption expenditures continuing to increase only moderately, personal saving rose very sharply. As payments of dividends to veterans tapered off in the second quarter, disposable income declined slightly; consumption expenditures continued to increase, however, and both the volume and rate of saving declined.
>
> In the third quarter disposable income advanced by the near-record amount of 9.1 billion dollars. Consumption expenditures, however, increased by 13.2 billion, and personal saving declined to 6.4 billion (annual rate) or only 3.1 percent of disposable income, the lowest rate since the first quarter of 1948. Personal saving and the savings ratio will probably show an increase in the fourth quarter.[33]

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[33] "Expenditures and Incomes in 1950." Federal Reserve Bulletin, 36:1565-76, December, 1950.

<u>Inventories</u>. The liquidation of business inventories in 1949 was a major factor in the decline of employment and income during 1949. A reversal developed early in 1950, accounting for much of the recovery in business activity in the first half of the year. More than half of the substantial increase in total national product from the last quarter of 1949 to the second quarter of 1950 was accounted for by the shift from large liquidation of inventories to substantial accumulation. Strong efforts were made to build up inventories following the outbreak in Korea, but sales of both consumption and capital goods increased so rapidly however, that inventories declined sharply in July. See Chart 8.

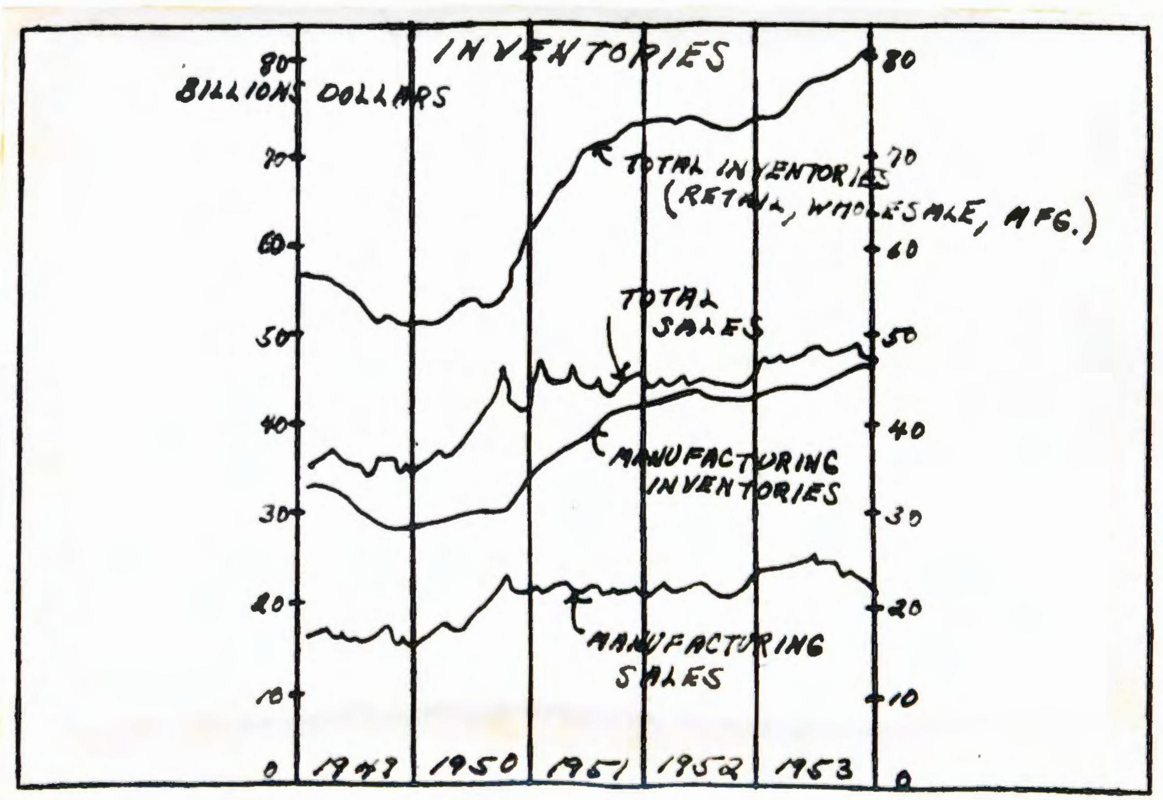


Chart 8. Inventories.
Source: Economic Indicators.

After July, with production at record levels, inventories increased and a substantial rate of accumulation occurred in the fourth quarter.[34]

Business and Government Expenditures. Total gross private domestic investment on a seasonally adjusted annual rate, (1951=100), in the second half of 1950 decreased from a second quarter annual rate of 53.2 billion dollars to 49.2 billion in the third quarter; private domestic investment increased in the fourth quarter at the annual rate of 61.9 billion dollars. New construction remained rather stable from a second quarter annual rate of 23.4 billion dollars to a fourth quarter annual rate of 24.1 billion. Producers' durable equipment followed a similar pattern over this time period from the annual rate of 23.9 billion dollars to 25.5 billion dollars. The dynamic factor again was changes in business inventories. The second quarter rate of annual change in inventories was +5.9 billion dollars, but by the third quarter, the annual rate of change had become a negative 1.3 billion, reflecting the tremendous consumer demand in July and August for both durables and nondurables. By the fourth quarter, the annual rate of change was again positive and at a high level of 12.3 billion dollars, reflecting in part the saturation of demand at this time.[35]

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[34] *Ibid.*, p. 1569.

[35] *Economic Report*, January, 1952, p. 169.

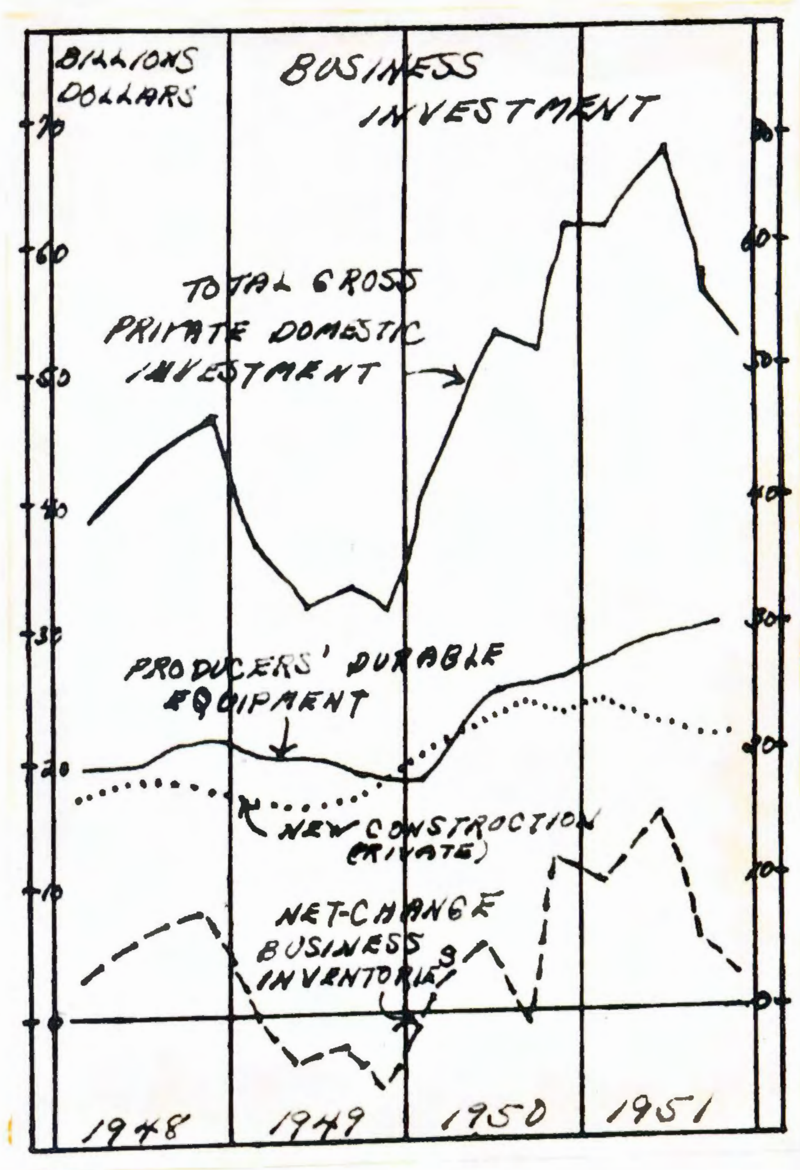


Chart 9. Business Investment.
Source: Economic Report, 1952.

Total federal, state and local government purchases of goods and services remained steady during the third and fourth quarters of 1950, but declined slightly in the third quarter. During the fourth quarter, there was an increase in total expenditures calculated on the seasonally adjusted annual rate of 43.1 billion dollars in the third quarter to the fourth quarter annual rate of 49.4 billion dollars.[36] This points out the fact that the defense effort was just beginning to increase from its pre-Korea conflict level and therefore was not a major force in the inflationary situation in the second half of 1950.

Employment and Wages. Unemployment declined between June and November, 1950, from 3,384,000 to 2,240,000. Unemployment as a percentage of the total civilian labor force decreased from 5.2 percent in June to 3.5 percent in November. One of the basic reasons for the decline was that the total labor force, including armed forces, declined from 66.2 million in June to 65.5 million in November while the armed forces also increased from 1.3 million in June to 1.9 in November. Thus there were two forces tending to decrease the ratio of unemployment to total civilian labor force, the decline in the total labor force and increase in the armed forces.[37]

The average weekly hours worked in manufacturing industries increased from 40.5 in June, 1950, to 41.1 in November. Simultaneously average hourly and weekly earnings in selected industries increased from the June level of $1.45 per hour or $58.85 per week to the November rate of $1.51 per hour or $62.23 per week.[38]

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[36] Ibid.

[37] Ibid., p. 177.

[38] Ibid., pp. 179-181.

Inflation, June-November. From the foregoing indicators of economic activity, it can be factually concluded that the third quarter of 1950, the period immediately following the Communist invasion of South Korea, was a period of hyper-inflation. This inflation arose from private, rather than public pressures. By this, it is meant that the impetus behind the forces of inflation came from the private business and consumer sector rather than the public or governmental sphere of economic endeavor. Consumer demand was propelled by fear and past experiences with inflations; scare buying was strong. Businessmen, with their eyes on future profits, demanded credit for production purposes. Immediate inventory accumulation for speculation and profiteering was the second force in the private sector of the economy which induced the inflationary environment upon the economy. While the fury was raging in the private sphere, we have seen that governmental economic activity was rather calm throughout the third and early part of the fourth quarters of 1950. Cash receipts for the Federal Government in the first half of 1950 were less than cash payments. But in the second half of 1950 cash receipts were greater than cash payments, giving an over-all cash surplus of the Federal Government for the year of .4 billion dollars. This surplus however was offset by the state and local governments having a cash deficit for the year of .9 billion dollars. The result was a cash deficit for all governments of .5 billion dollars.[39] Gross public federal debt declined a small

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[39] Ibid., p. 160.

amount from the June, 1950, level of 257.4 billion dollars to the October level of 257.0 billion dollars, but after that a small increase occurred.[40] This is further evidence that the inflation was perpetrated primarily by forces in the private segment of the economy in the immediate six months that followed the outbreak of the Korean War. The inflation in this period, or in the immediate six months following, cannot be blamed upon huge governmental deficits financed by what businessmen like to call "monetization of public debt." This type of public financial policy labeled as the basic cause of inflation in the last few decades by businessmen and their outspoken leaders, was not in existence at this time. Yet, we had a tremendous inflation during this period. The businessmen's thesis is that price fluctuations and scare buying are only symptoms of an inflation. Therefore, they say price, wage and rationing controls do not get to the cause of inflation, and do not hold as being valid during this period of spiraling prices. Inflation does, however, feed on inflation.

By the latter part of September and early October, 1950, the consumer buying spree of July and August had subsided. Price indexes on wholesale and retail levels were not advancing as rapidly as they had in the previous 12 weeks. The industrial production index declined one point. Anticipations were that the "police action" in Korea would be over in a short time. The assumption was that the defense

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[40] *Ibid.*, p. 195.

program would move forward by stages with defense expenditures reaching a peak rate in two years.

"It followed that for the first twelve months, the diversion of productive resources would not require drastic readjustment of the civilian economy. The initial program of the President to stabilize the economy was based upon this hypothesis."[41]

4. Third Phase: Intensified Mobilization

The Chinese intervention in late November blasted the hope that the Korean campaign could be brought quickly to a close and that the G.I.'s would be home for Christmas. Russia's support of China disclosed dangers of incalculable magnitude and made necessary a vigorous increase in the speed and size of defense preparations.[42] Selective Service calls were increased 100 percent in mid-winter. Military procurement plans were revised upward. In December, Congress was asked to appropriate additional funds, but there was no great change in the placement and scheduling before the end of 1950. Industrial production in December remained close to the level established during October and November. Employment (when seasonal variations are removed) was steady. Yet, national income and consumers income continued to rise under the impact of rising prices and rising

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[41]<u>Economic Report</u>, January, 1951, p. 38.

[42]<u>Ibid</u>., p. 39.

wages. Thus the economy had entered into the third stage of the economic history of 1950. This period was to become one of renewed inflation with an intensity similar to that of the early third quarter, 1950. The period was to extend from late November, 1950, to February and March, 1951.

Prices. Prices again began to rise rapidly. The wholesale price index, (1947-49=100), all commodities, in September and October had been rather steady. In October, it was 107.7, but by February, 1951, it had risen by 8.8 points to an all time high of 116.5 percent. This is an 8 percent increase over the October level. The consumer price index, (1935-39=100), all items, was also moving upward. In October, 1950, it was 175.6 by February, 1951, it had advanced 8.2 points to 183.8 percent, a percentage increase from October of 4.1.[43] In view of the following table of selected items, it is clear that food led the flock. It was followed by house furnishings and wearing apparel. The others remained stable.

TABLE V

INCREASES IN SELECTED ITEMS, CONSUMER PRICES
(1935-39=100)

| Item | Nov. 15, 1950 | Feb. 15, 1951 | Point Increase |
|---|---|---|---|
| Food | 210.8 | 226.0 | 15.2 |
| Apparel | 194.3 | 202.0 | 7.7 |
| Rent | 132.5 | 134.0 | 1.5 |
| Fuel, Electricity and Refrigeration | 142.5 | 143.9 | 1.4 |
| House Furnishings | 201.1 | 209.7 | 8.6 |

Source: Federal Reserve Bulletin

[43] Economic Report, January, 1952, pp. 188-189.

Selected classes of commodities on the wholesale level of prices also continued their upward trend from November to February. Leaders in the field were farm products; hides, skins and leather; processed foods; chemicals and allied products; textile products and apparel and some metals and machinery. Other items are shown in Table VI below.

TABLE VI

INCREASES IN SELECTED ITEMS, WHOLESALE PRICES
(1947-49=100)

| Items | Nov., 1950 | Feb., 1951 | Point Increase |
|---|---|---|---|
| Farm Products | 104.2 | 117.2 | 13.0 |
| Processed Foods | 103.5 | 112.9 | 9.4 |
| Textile Products & Apparel | 109.1 | 115.7 | 6.6 |
| Hides, Skins & Leather | 116.6 | 127.7 | 11.1 |
| Fuel, Power & Lighting | 105.4 | 107.4 | 2.0 |
| Chemicals & Allied Prods. | 103.4 | 112.6 | 9.2 |
| Rubber and Products | 149.2 | 152.5 | 3.3 |
| Lumber & Wood Products | 122.7 | 126.4 | 3.7 |
| Metal & Metal Products | 117.7 | 123.7 | 6.0 |
| Machinery & Motive Prods. | 112.8 | 117.7 | 4.9 |
| Nonmetallic Minerals - Structural | 110.7 | 113.7 | 3.0 |

Source: Federal Reserve Bulletin

Reasons given for these swift elevations in the wholesale and retail indexes are: (a) efforts by sellers to increase prices before price freezes; (b) the evaluation by businessmen of the pressure on prices which would flow from an accelerated defense program; (c) continuing upward trend of money incomes; (d) the seasonal Christmas spurt in sales; and (e) possibly renewed scare buying.

Monetary and Credit Position. Monetary and credit policy at this time was an important factor behind the inflationary situation, especially the relation between the Treasury and the Federal Reserve System. Beginning in the latter part of 1949 and early 1950 when the recovery began to make its appearance, the money markets began to tighten; interest rates, to rise. When the Korean War broke out and inflationary pressures became evident, officials of the Federal Reserve System thought it was their place to use their delegated powers to help control this run-away inflation. Thus, the Treasury-Federal Reserve feud, which had been evident in the post second World War inflation, broke out into the open again. It continued with threats of resignations from members of the Board of Governors, while President Truman and his Council of Economic Advisers were supporting the Treasury's position of low interest rates. The fight continued until the middle of March when an accord or agreement was reached whereby the Federal Reserve System stopped the policy of supporting government long and short term securities, and ceased being an "engine of inflation."

But the damage had been done. The barn door had been closed after part of the horse had been stolen. From November, 1950, to February, 1951, prior to the accord, government obligations held by the commercial banks declined from 61.5 billion dollars to 58.9 billion dollars, while in that same period, Federal Reserve Bank holdings of government obligations increased from 19.7 billion dollars to 21.9 billion dollars while total government obligations outstanding declined by 1.1 billion dollars. One conclusion from this is that the banks were drawing down their holdings of Government securities in order to grant business loans, which in turn were directly feeding the forces of inflation.[44] During the same period, investments of all commercial banks declined from 73.9 billion dollars to 71.5 billion of which United States Government securities declined from 61.7 billion dollars to 59.1 billion. Other securities increased from 12.1 to 12.4 billion dollars. Total loans of all commercial banks during this period increased from 51.5 billion to 53.5 billion or, a 2 billion dollar increase.

Two writers pointed out the laxity found in general monetary controls because of the Federal Reserve policy of supporting government securities, which in turn, was one of the chief factors leading to increased inflation. They pointed out in tabular form, which is reproduced below, that part of the inflation was due to the increase in member bank reserves because of such a policy.

But Steiner and Shapiro failed to point out the fact that the reserve requirement increases did not occur until the 11th of January, 1951, and therefore the increase in member bank reserves prior to that date would be the 3.1 billions before the reserve requirements were increased and that this was the inflationary period and not after March when the increased reserve requirements did take effect.

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[44] "The Reluctant Bankers." New Republic, 123:9, December 4, 1950.

TABLE VII

INCREASE IN RESERVES AVAILABLE FOR EXPANSION IN THE BANKING SYSTEM, JUNE 30, 1950, TO MARCH 28, 1951

| | (Billions of dollars) |
|---|---|
| Increase in Government security holdings of the Federal Reserve banks: | +4.3 |
| Increase in all other Federal Reserve credit: | +0.9 |
| Decrease in monetary gold stock: | -2.4 |
| Decrease in money in circulation: | +0.1 |
| Other factors, net: | +0.2 |
| Increase in member bank reserve balances: | +3.1 |
| Less: Increase in required reserves due to increases in reserve requirements: | -2.0 |
| Increase during period in reserves available for expansion: | +1.1 |

Source: W. H. Steiner and Eli Shapiro, Money and Banking. Henry Holt Co. (New York, 1953), p. 719.

By calculation with the formula used above, the money supply increased by 1.3 billion dollars from November 29, 1950, to February 28, 1951. Components determining this increase were: demand deposits up 300 million dollars; U.S. Government deposits at commercial and Federal Reserve banks up 1.1 billion dollars; foreign deposits up 100 million dollars; currency outside the banks down 300 million dollars. On the asset side of the consolidated balance sheet: gold holdings were down 900 million dollars; loans were up 2.4 billion dollars; holdings of U.S. Government securities down 700 million dollars and other security holdings up 300 million. These fluctuating factors give a money supply of 123.6 billion dollars on February 28, 1951.[45]

[45] Source, Federal Reserve Bulletin. Data will not balance because of rounding and omissions.

Demand deposit turnover on November 29, 1950, was 28.1 in New York City and 14.9 in other reporting centers; by February, 1951, the rate of turnover in New York City had declined to 26.1 and in other reporting centers to 14.3. Thus, with an increase in the money supply, there occurred a decline in expenditures in the latter half of February, 1951.[46]

Personal Consumption Expenditures, Saving and Installment Credit. From November, 1950, to February, 1951, personal consumption expenditures increased from a fourth quarter seasonally adjusted annual rate of 198.4 billion dollars to 208.2 billion dollars, a reflection of mid-winter seasonal buying plus the spurt in consumer purchases of durables, nondurables and services following the entrance of the Chinese Communist armies into the war in Korea.[47] Total consumer credit (as seen in Chart 10) had its mid-winter seasonal increase in December, 1950, increasing from the November, 1950, level of 19.4 billion dollars to the December, 1950, level of 20.1 billion dollars and then dropping back in February, 1951, to 19.5 billion dollars.[48] This reflects the effectiveness of Regulation W upon consumer credit which had been imposed in the fall of 1950 and also the saturation of consumer demand for durable goods by this time.

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[46] Federal Reserve Bulletin, December, 1951, p. 1542.

[47] Economic Report, January, 1952, p. 167.

[48] Ibid., p. 192.

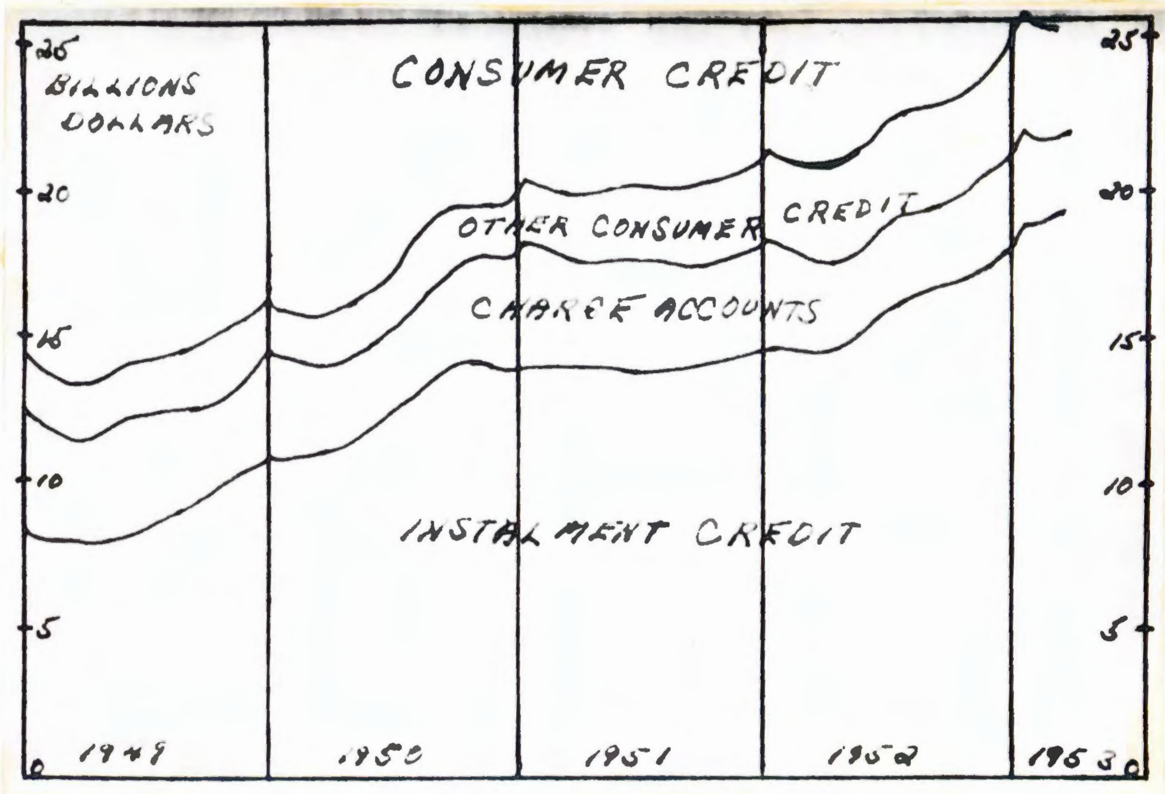


Chart 10. Consumer Credit.
Source: Economic Indicators

Personal saving decreased in the fourth quarter 1950 and first quarter 1951 from a seasonally adjusted annual rate of 16.8 billion dollars to 8.5 billion dollars. Since net saving as a percentage of disposable personal income also fell from 7.8 percent to 3.9 percent, this also indicates the increase in personal consumption expenditures during this period.[49]

Business and Government Expenditures. During the last quarter of 1950 and the first quarter of 1951, the

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[49] *Ibid.*, p. 175.

gross national product increased on the seasonally adjusted annual rate from 303.7 billion dollars to 319.0 billion dollars. The strong factors behind the increase were: (a) increased consumption expenditures as we have shown above, (b) increased government purchases of goods and services from an adjusted rate of 47.8 billion dollars to 53.4 billion dollars, while gross private domestic investment remained stable at 60.2 to 60.1 billion dollars on the quarterly annual rate.[50] This change in the component parts of GNP is in contrast to the inflation period in the third quarter of 1950. In the earlier quarter, business investment and personal consumption were the driving forces; in the later inflationary episode, government investment and again personal consumption gave impetus to renewed inflation.

Inventories. The ratio of total manufacturing and trade inventories to sales which reached a post-Korean invasion high in November of 1.45; declined to 1.43 in December, 1950; 1.35 in January, 1951, and increased in February to 1.41 and 1.47 in March of 1951.[51] A further indication of rather strong demand relative to supply; the vital law of inflation.

Employment and Wages. Unemployment increased in mid-winter, 1950-51, from a November level of 2,240,000 to

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[50] *Ibid.*, p. 167.

[51] *Ibid.*, p. 186.

a February level of 2,407,000. Unemployment as a percentage of the total civilian labor force increased in that identical time period from 3.5 percent to 3.9 percent.[52] But the outlook was for increased employment which later did materialize. While the average work week in selected industries declined from 41.1 to 40.9 hours,[53] weekly earnings rose from $62.23 to $63.84.[54] This was an indication of increased bargaining power of the labor unions, but it was not because of the tightening of the employment situation. As we have seen, unemployment was increasing at this time. But it was due to the fact that employers were willing to grant voluntary wage increases in mid-winter, 1950-51, in order to be in a better bargaining position later on when labor would be scarce and the wage freeze would prevent certain employers from having the bargaining strength to call for the use of more labor power.[55]

We can see from the foregoing economic indicators and supplementary discussion that the inflation was a great danger and of vital concern to the average American. Some members of society do gain in an inflationary period, but they are in the minority. As President Truman stated in his opening message of the midyear Economic Report: "....Those fortunate enough to have rising incomes were able to maintain their living standards. But more than half the

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[52]Ibid., p. 177.

[53]Ibid., p. 179.

[54]Ibid., pp. 180-181.

[55]Economic Report, Midyear, 1951, p. 40.

families of the Nation had no income gains between early 1950 and early 1951 and almost one-fifth suffered actual declines."[56]

The question might be raised as to what was done during these eight months after June, 1950, when wholesale prices rose on the average of 15.3 percent and consumer prices by 8.4 percent. At the same time the money supply had increased by 4.8 billion dollars. Loans and investments of commercial banks had increased, roughly by 6 billion dollars, and consumer expenditures were at an all-time high and consumer credit was expanding. During this same period unemployment was at a post-World War II low, and many industries had reached their productive capacities. It was at this time that wage increases were quickly granted, thus leading to greater income and expenditures.

What was being done to subdue this economic disease of social inequity?

### 5. Controls, June, 1950 - February, 1951

Some steps were taken to control the economy during this time. The discount rate at all Federal Reserve banks was raised from 1.5 to 1.75 percent in order to discourage member banks from adding to their reserves, the increase being accompanied by the statement that, "Within the past

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[56] Ibid., p. 13.

six weeks loans and holdings of corporate and municipal securities have expanded by 1.5 billion dollars at banks in leading cities alone. Such an expansion under present conditions is clearly excessive."[57] However, because the Federal Reserve System was following the policy of pegging government securities, this tool was not too effective as seen by the amount of U.S. Government securities that the commercial banks shoved onto the Reserve banks. Secondly, open market operations were directed toward discouraging sales to the Federal Reserve banks of short-term U.S. Government's, including sales by banks for reserves. Early in August the Board of Governors joined Federal and state bank supervisory agencies in requesting voluntary cooperation of banks and other lenders in restricting credit expansion. Effective September 18, 1950, under authority of the Defense Production Act, the Board of Governors placed consumer installment credit under Regulation W, which increased minimum down payments and reduced maximum periods over which installment credit could be paid off. Later, on October 16, Regulation W was strengthened by again increasing down payments and reducing payment periods. Effective October 12, the Board of Governors under authority of the Defense Production Act, with concurrence of the Housing and Home Finance Administrator, placed under regulation credit not extended, insured or guaranteed by the Federal Government, Federal

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[57] Federal Reserve Bulletin, 36:1110, September, 1950.

Housing Administration or the Veterans Administration. The Treasury also raised the limits on the purchase of Series F and G savings bonds in order to encourage more saving. More selective credit restraints were attempted through Regulation X on real estate and Regulations T and U on credit granted to brokers and dealers for carrying securities. There were two significant tax measures taken during this 8-month period. The first was initiated almost immediately after Korea. Agreement was reached between the Administration and Congress to convert the pending tax revision bill that was then under debate into a substantial revenue-raising measure. The President requested an increase in taxes of 5 billion dollars; the Congress enacted an increase in taxes of 4.7 billion dollars. Legislative action was completed in sufficient time for higher income tax withholding rates to become effective October 1, 1950. The second measure was the Excess Profits Tax Act of 1950, which was passed in the final week of the 81st Congress and affected approximately half of the 1950 profits. In 1951, there was a new Revenue Act which did not become effective until October of that year and which adopted one-half of the revenue asked by the President from individual, corporation and excise tax sources.[58] The seriousness of the inflation was not felt until after "Red China" entered the Korean affair in late November.

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[58] Economic Report, January, 1952, pp. 131-132.

On December 16, 1950, the President declared an emergency proclamation and established the Office of Defense Mobilization and the Economic Stabilization Agency under the Defense Production Act, 1950. Wage and price controls were then placed into effect replacing the freeze which had been in effect since the first of January. Materials allocation was set up under the National Production Authority but did not become effective until summer of 1951. The Board of Governors again came back into the picture with more anti-inflationary policy in the form of an increase in member bank reserve requirements in January, 1951. Reserve requirements at Central Reserve City and Reserve City banks were increased on January 11, from 22 percent to 23 percent and from 18 percent to 19 percent respectively on demand deposits and from 5 to 6 percent on time deposits for all classes of banks. Country bank reserve requirements for demand deposits were increased from 12 percent to 13 percent, but not until January 16. Later that month, January 28, the Central Reserve City and Reserve City banks reserve requirements were again increased one percent to 24 and 20 percent respectively, and the Country banks reserve requirement was advanced from 13 to 14 percent the first of February, 1951. This was of course an anti-inflationary step.

In pointing out attempts to curb the inflationary impact, it has been seen that the economic disease of spiraling prices always seemed to be one step ahead of any controls which could be imposed for inhibiting this menace. By the end of February, 1951, it appeared that the inflationary pressures had subsided, supplies were catching up with demands, prices had stabilized and inventories were again coming into alignment with sales. The short-run outlook was for a slackening in inflationary pressures, but in the long-run, the possibility for greater inflation was still imminent because Government defense expenditures were just beginning to take greater portions of the GNP and would continue to do this. In the first half of 1950, defense expenditures were at the annual rate of 12 billion dollars; in the third quarter at an annual rate of 14 billion dollars accounting for about less than 5 percent of the total gross national product. In 1951, defense expenditures were expected to more than double those of 1950, and from an ex post point of view they did just that. Thus to have slackened the economic controls then might have proven disastrous in the future. The intelligent policy was to strengthen controls as much as possible and not to be caught asleep at the switch, as had happened in mid-1950. As the Council of Economic Advisers pointed out in the January, 1951, Economic Report of the President:

> At the end of 1950, the national economy was subject to forces of inflation far more powerful than those which arose following the original outbreak in Korea. Originally, the advances in prices, which had slowed down during the mid-autumn, was accelerated under pressures which promised to continue until curbed by positive action. The outlook is that to these pressures there will soon be added the direct effects of the rapidly expanding military program, with its increasing draft upon productive resources.[59]

[59] Economic Report, January, 1951, p. 42.

## CHAPTER III

## THE VOLUNTARY CREDIT RESTRAINT PROGRAM

### 1. Need for the Program

As it was pointed out in the last few paragraphs of Chapter II, the inflationary forces had subsided somewhat by March of 1951. But also it was shown that national security expenditures, which had only been taking a 5 percent payment out of the gross national product in 1950, would more than double in 1951 over the 1950 level of defense expenditures. Thus, in addition to the general potential inflationary forces - which had receded in the early months of 1951, but which were expected to become more active as the year moved forward, especially in the later months of the second half of 1951 - were superimposed the anticipations of increased stepped-up national security expenditures. Consequently, this was no time to be thinking of relaxing the anti-inflationary controls which had been placed into commission in the previous eight months. Actually during this period, greater steps were being taken to stabilize the present and future inflationary pressures. The price-wage freeze, which had been in service since January 1, 1951, of course could be expected to serve only as a temporary stop-gap measure. A more effective and stronger measure in the form of price and wage ceilings with adequate enforcement provisions was being undertaken by the creation of the

Office of Price Stabilization and the Wage Stabilization Board whose duty it would be to promulgate and enforce these ceilings. But the establishment and elevation of these control agencies to an effective and forceful position in the defense economy could not be accomplished overnight. Studies had to be made, employees and administrators hired and trained, forms printed and routines of procedure and channels of communication set up. This meant delay and the loss of vital time as well as failure to curb the dangerous inflation threats. Another reason for the delay in the imposition of price and wage controls was the fact that the great upward movement of prices and wages prior to the general freeze in January had not been uniform. Some prices had greatly outrun others. A similar condition had occured to wage levels. This meant that comprehensive studies would have to be made before controls could be imposed in an equitable manner.[1] Another factor which resulted in more delay in getting wage and price ceilings into position as a contra-inflationary measure was the multiplicity of amendments which successful pressure groups had appended to the Defense Production Act. "....The amendments weakened the powers of price control by preventing certain necessary actions and by requiring a number of adjustments all of which could only have the effect of raising ceiling prices....."[2]

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[1] Economic Report, January, 1952, p. 144.

[2] Ibid.

Thus a program of workable price and wage control structures had to wait until the mid-summer or early autumn of 1951 before they could be considered a substantial factor in the over-all policy of inflation control.

Another important step taken at this time to ward off the further evils of spiraling prices was the Federal Reserves' open market policy of ceasing to support long term government securities. This was an indirect step chiefly in the monetary and credit field to which reference was made in Chapter II. By removing the pegs from U.S. Government obligations, prices of these securities were allowed to seek their levels. As a result, they immediately fell below par. Because of this, institutions holding such securities would take a capital loss if they attempted to sell their bonds. This policy was principally aimed at the commercial banks which prior to this were unloading their U.S. Government securities onto the Federal Reserve Banks at the supported prices and building up reserves upon which inflation-feeding industrial and commercial loans could be extended. When the Treasury-Federal Reserve accord was reached on March 12, 1951, the inflationary forces of credit expansion were greatly inhibited by this long over due policy change.

Therefore, it can be concluded from the evidence pointed out in the immediate few paragraphs above and the discussion on controls in the last part of Chapter II that those officials in charge of the anti-inflationary program of the government were not anticipating a lull in the war against inflation. The government was pursuing a "shotgun method" vis a vis inflation, that is, no anti-inflation techniques were left untapped, no stops left open in the struggle against rising prices. Even a new technique of inflation control was being devised for a trial run.

A need was felt in the area of institutional investment for a program which would be an anti-inflationary policy as well as a device for the diversion of funds from nonessential to essential purposes. Concerning this, the Federal Reserve System stated:

> Institutional investors, including life and property insurance companies, commercial and mutual savings banks, and savings and loan associations, are at present the principal sources of long-term investment funds, while commercial banks have long been major sources of short-term business credit. During the postwar period 1946-50, additions to the investment portfolios of these institutions accounted for 88 percent of the increase in real estate mortgage debt, and for 77 percent of the increase in long-term corporate and State and local government debt. At the end of 1950, ....they held three-fourths of all real estate mortgage debt, over half of all State and local and long-term corporate debt, and over two-fifths of Federal debt outstanding.
>
> If the investment and lending activities of these financing organizations could be directed, through a program of voluntary credit restraint, toward the restriction of speculative uses of credit and the diversion of funds from nonessential to essential purposes, there was a real possibility that such action would help to check inflationary pressures and facilitate the diversion of labor and materials to essential uses.[3]

In answer to this wish and as one of the new pellets in the Federal Government's "shotgun barrage" against the inflationary forces, was the Program for Voluntary Credit Restraint. This program received great plaudits from those who initiated and participated in its proceedings, worked under its policies and were implemental in carrying forward its courses of action. On the other hand, public officials,

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[3]"Voluntary Action to Help Curb Inflation." Reprint, <u>Federal Reserve Bulletin</u>, November, 1951, pp. 2-3.

business leaders and many economists who were not closely associated with this program took a more or less neutral or hands-off position in discussions of its value or worth as an anti-inflation force. This latter position is partly due to the inherent characteristics of the program itself - which will be discussed later - and partly due to the absence of any comprehensive or over-all study of the program per se. In this paper, then, there will be an attempt to point out the former and remedy the latter while attempting to arrive at precise conclusions as to the value of the program under various conditions which impede or improve its usefulness as a force against inflation.

## 2. Genesis of the VCRP

Introduction. The previous statement that this Program for Voluntary Credit Restraint was a completely new anti-inflationary technique may not prove to be entirely true when the background of this program is examined.

But before the history behind this program can be presented, it will be necessary to give a brief description of the program itself for it would be difficult to present the origin of this credit restraint technique without first giving the reader an enlightenment into the characteristics of the program. Searching into history without some preconceived ideas or concepts of what the aims of the search are intended to uncover is often nebulous and mentally exhausting.

The Voluntary Credit Restraint Program, in the general terms of a synoptic preview, was an attempt upon the part of those individuals and institutions which were directly associated with the financial aspects of the American economy to devise a technique of self-control which would lead to the promotion of the defense effort and simultaneously restrict and help stabilize various inflationary pressures. Those directly participating were officials of commercial banks, investment banks, life insurance companies who were later joined by the officials of mutual savings banks, savings and loan associations plus various other minor financial institutions. Since these institutional investors were the main sources for capital and credit other than various government financial institutions, it was more than appropriate that some type of control be imposed in the sphere of institutional investment. These financial institutions under the auspices of the Board of Governors of the Federal Reserve System were mainly represented by their respective trade associations. General principles of policy were established to govern the lending policies of these financial institutions along with a National Committee and quite a few regional and subcommittees which were to be the guiding hands in the program. The principles of the program and the bulletins, after being widely promulgated, were used as screens and bench marks by which the lending officials of the participating institutions could transform their former lending principles and conditions into a unified program of lending guides designed to help promote the defense effort and control inflation. The program was voluntary under government sanction; there was no direct compulsion that required the financial institutions to comply with its principles.

From this brief preview there can be obtained a general sketchy concept of the Voluntary Credit Restraint Program. After the background and policy forerunners of this program have been discussed, there will be presented a much greater detailed discussion of the program in the last part of this chapter.

Origin and Background - Capital Issues Committee. The genesis of this type of technique for defense or war finance and anti-inflation control goes back to World War I and the organization of a Capital Issues Committee. This committee was brought together under the need pointed out by the then Secretary of the Treasury McAdoo in his annual report to Congress in 1917. At that time he referred to the importance of avoiding unnecessary capital expenditures in both public and private enterprises.[4] With no specific governmental authority conferred upon the Secretary of the Treasury or the Federal Reserve Board to approve or disapprove the undertaking, "A number of corporation executives, bankers and municipal officials submitted plans for new enterprises, and thereupon the Secretary of the Treasury requested that all persons contemplating offering securities for sale or subscriptions, first submit them for an expression of opinion as to the compatibility of the proposed issues with the

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[4] Fifth Annual Report of the Federal Reserve Board, 1918, p. 64.

national interest."[5] Following this announcement, offerings for an expression of opinions on tentative financial programs were so great that it soon became evident that a more formalized procedure was necessary. Therefore, in a letter dated January 11, 1918, Secretary McAdoo requested the Federal Reserve Board "....as another patriotic service, to assume the responsibility of passing upon such proposals as may be submitted, both in respect to capital expenditures or issues of new securities."[6]

The Board then appointed three of its members as a committee to undertake the enlistment of various members of financial institutions to act as a voluntary advisory committee to assist in its work. An auxiliary committee, composed of five members, including the Federal Reserve agent, who acted as chairman, and the governor of the Federal Reserve Bank, was appointed. All served without pay.[7]

Work began February 1, 1918. The committee resolved to pass upon industrial and public utility issues of no less than $500,000 and municipal issues of no less than $250,000. Minimums were later reduced to $100,000.[8]

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[5] Ibid.

[6] Ibid.

[7] Ibid., p. 65.

[8] Ibid.

The tests applied to security issues were: (a) whether the issue was timely and in conjunction with the financial policies of the government and (b) whether the funds to be raised would be used in the public interest.[9]

On April 5, 1918, Article II of the War Finance Corporation Act, gave legal sanction to the Capital Issues Committee on authority granted to the President. The new committee automatically superseded the voluntary committee of the Federal Reserve Board. Then, under government sanction it adopted the same general plan of administration and the same local committees as the previous committee had been using.[10]

As to the effectiveness of this Capital Issues Committee, the Federal Reserve Board stated:

> Notwithstanding its purely voluntary nature and the absence of specific legal authority, the committee, by reason of the hearty cooperation of other governmental agencies and of bankers' associations, as well as of lending stock exchanges, was able, during its brief existence, to effect a considerable stoppage of non-essential security issues.[11]

In a statistical table, it was further pointed out that of a total of 479 million dollars in issues considered 66 million dollars was disapproved. Of the amount approved, 259 million dollars was for refunding, leaving a sum of 154 million dollars of approved new issues. This 154 million

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[9] *Ibid.*

[10] *Ibid.*, p. 66.

[11] *Ibid.*, p. 65.

dollars of new issues was then compared with the same period in 1917, the year previous, of new issues of 504 million dollars roughly 3 1/3 times greater.[12] This is pointed to as further proof of the efficacy of the program. But as it will be seen in the evaluation of the recent Voluntary Credit Restraint Program, just because the regional and national committees disapproved the capital extension does not mean that the advice was followed; because from the voluntary nature of the program, there was no means of seeing that the financial institutions did follow the opinions rendered by the regional and National bodies.

Capital Issues Committee - VCRP. From this brief description of the Capital Issues Committee of World War I, there can be recognized many likenesses and unlikenesses with the present program under scrutiny here. In the first instance, the two programs were similar because both were voluntary in administrative composition, and both were staffed by the identical individuals who were being controlled. That is, these two programs were techniques of self-control. Secondly, they both worked in close coordination with the Federal Reserve System and under government sponsorship. Thirdly, they were primarily concerned with promoting defense and war efforts and simultaneously reducing inflationary pressures by restraining unnecessary demands upon capital, labor and other productive resources.

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[12] Ibid.

Dissimilarities are found in the fact that the Capital Issues Committee, as seen from its title, was principally concerned with the finance of capital securities, whereas the Voluntary Credit Restraint Program - as it will be seen later- not only dealt with this problem of inflation stemming from capital finance, but in the broader fields of inventory, real estate, working capital, capital investment, speculation et cetera. A second difference found between these two techniques of credit control is that VCRP was on a more formalized basis. By this is meant there was more thought put behind its conception, there was a greater inclusiveness in scope and the program was more formalized through means of communication and techniques of administrative procedure. This is possibly due to the experience accumulated during the first attempt at any device of this type during World War I to the most recent attempt of war control technique.

But, the important point here is not whether they were similar or dissimilar, but that the Capital Issues Committee of 1918 was a forerunner of the recent Voluntary Credit Restraint Program.

Moral Suasion - A Predecessor. Some authorities have classified the Voluntary Credit Restraint Program as formalized moral suasion. They define moral suasion as the use of persuasion based on an appeal to moral and ethical values. These critics classify moral suasion into two types. One they call the indirect type of contact through oral or written statements, appeals and warnings through policy statements, the press et cetera. The second or direct type of moral suasion is through supervisory processes, informal consultations et cetera. These writers point out that:

> The most recent and most formalized use of direct contacts has been under the voluntary credit restraint program which includes insurance companies, investment banks, mutual savings banks and savings and loan associations as well as commercial banks. This organized effort at direct contacts was instituted under authority granted by the Defense Production Act of 1950 and has the objective of encouraging lenders to limit the use of private credit for nonessential and speculative purposes and thus to help restrain inflationary pressures from this source during the period of national defense emergency.....[13]

They go on to relate that moral suasion was used in late 1919 and early 1920 when the Federal Reserve Board, concerned about inflation trends, issued warnings that Federal Reserve credit should not be used either directly or indirectly to finance speculation. In its Annual Report for 1923, the Board strongly expressed its preference for "productive credit" as contrasted to "credit for either investment or speculative purposes," the essence of the VCRP. A classic period was in the expansion of speculative credit in the late twenties when the Board issued statements in its monthly Bulletins and Annual Reports against speculative credit expansion but to no avail. The same has been done in recent periods of inflation, but moral suasion as a tool for

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[13]"Monetary Policy and the Management of the Public Debt." Senate Document No. 123, Part 1, 1952, p. 463.

monetary and credit control has proven to be ineffective in the past. This is not intended to be an invective against moral suasion or to point up its ineffectiveness in dealing with problems of inflation. It is stated here merely to reveal that moral suasion as used in the recent past has been a forerunner to the Program for Voluntary Credit Restraint, if one accepts this program as formalized moral suasion.

A.B.A.'s Influence. When the VCRP was briefly defined a few paragraphs above, it was pointed out that several financial trade associations had been instrumental in the organization and the functioning of this program. The American Bankers' Association was one of these trade groups. Not only was the A.B.A. influential in establishing and promoting the Voluntary Credit Restraint Program, but it also had been deeply involved in promoting several predecessor schemes of a similar voluntary nature among its members. This occurred years before the government gave its recognition to the voluntary anti-inflationary and defense promoting technique in early 1951. This organization, which is the principal financial trade association of the commercial bank officials in this country, in the post World War II inflation took upon itself to set into motion a program among its members of an anti-inflationary type similar to the VCRP but without governmental sponsorship. This program was an attempt by the leaders of the American Bankers' Association via the use of moral suasion to persuade their fellow bankers to hold down excessive credit extension which was a primary force in the inflation of 1947-48.

Thus, the Voluntary Credit Restraint Program cannot be said to be a completely new method of inflation control. "In a large sense, ....the idea had its roots in the A.B.A.'s voluntary credit restraint program of 1948, which was credited with achieving a great success."[14]

3. The Program Per Se

Organization. The Defense Production Act of 1950, which was the legislative reply to the request of the Truman Administration for power to expand the defense program, maintain a sound defense economy and carry on the Korean War, was the legislative enactment which gave government recognition to the VCRP. This package of legislation was all-inclusive. Title I dealt with priorities and allocations; Title II dealt with authority to requisition and condemn; Title III was concerned with the expansion of productive capacity and supply; Title IV pertained to price and wage stabilization; Title V dealt with the settlement of labor disputes; Title VI was concerned with control of consumer and real estate credit and Title VII was a general provisions section. The Act became effective on September 8, 1950. In a perusal of the Congressional Record concerning debate upon the Act, much discussion is found centered around wage and price controls, priority and allocation power and means of

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[14]"The Roots of Voluntary Credit Restraint." Banking, 43:34, June, 1951.

settling labor disputes, but little if any, centers around the Voluntary Credit Restraint Program. This was due to the fact that the idea of such an anti-inflation tool was not known to the legislators at that time. Power to enter such voluntary schemes was referred to in general terms, but no specific single device was debated. When the Act was finally passed, that section giving government sanction to the VCRP was Title VII, the general provisions title. In this title, power was given only in general language leaving one to conclude that the VCRP was only one of many voluntary devices contemplated under this provision. Actually 24 such agreements were established, but none was to be more sustaining or receive more publicity than the Voluntary Credit Restraint Program.

As it was pointed out above, Title VII of the Defense Production Act gave government endorsement to the VCRP. Section 708 (a), (b), (c), (d), and (e) of the Act stated:

> Section 708 (a). The President is authorized to consult with representatives of industry, business, financing, agriculture, labor and other interests, with a view to encouraging the making by such persons with the approval by the President of voluntary agreements and programs to further objectives of this Act.
> (b) No act or omission to act pursuant to this Act which occurs while this Act is in effect, if requested by the President pursuant to a voluntary agreement or program approved under subsection (a) and found by the President to be in the public interest as contributing to the national defense shall be construed to be within the prohibition of the antitrust laws or the Federal Trade Commission Act of the United States. A copy of each such request intended to be within the coverage of this section, and any modification or withdrawal thereof, shall be furnished to the Attorney General and the Chairman of the Federal Trade Commission when made, and it shall be published in the Federal Register unless

publication thereof would in the opinion of the President, endanger the national security.
(c) The authority granted in subsection (b) shall be delegated only (1) to officials who shall for the purpose of such delegation be required to be appointed by the President by and with the advice and consent of the Senate, unless otherwise required to be so appointed and (2) upon the condition that such officials consult with the Attorney General and Chairman of the Federal Trade Commission not less than ten days before making any request of finding thereunder, and (3) upon the condition that such officials obtain the approval of the Attorney General to any request thereunder before making the request.. For the purpose of carrying out the objectives of Title I of this Act, the authority granted in subsection (b) of this section shall not be delegated except to a single official of the government.
(d) Upon withdrawal of any request or finding made hereunder the provisions of this section shall not apply to any subsequent act or omission to act by reason of such finding or request.
(e) The Attorney General is directed to make, or request the Federal Trade Commission to make for him, surveys for the purpose of determining any factors which may tend to eliminate competition, create or strengthen monopolies, injure small business, or otherwise promote undue concentration of economic power in the course of the administration of this Act. The Attorney General shall submit to the Congress and the President within ninety days after the approval of this Act and at such times thereafter as he deems desirable reports setting forth the results of such surveys and including such recommendations as he may deem desirable.

On September 9, 1950, the day after the Defense Production Act became effective, Executive Order 10161, delegating the President's power for entering into voluntary agreements with many segments of business finance, labor and agriculture, was issued. The pertinent clause which transferred the authority from the President to the Board of Governors of the Federal Reserve System and which led to creation of the Voluntary Credit Restraint Program was:

Section 701 (a). The functions conferred upon the President by section 708 (a) of the Defense Production Act of 1950 are hereby delegated as follows:
(2) To the Board of Governors of the Federal Reserve System with respect to financing.

By this executive action, the Board of Governors became the alter ego of the President in the matter of financial voluntary agreements in promoting the defense effort and countering inflation.

There was a delay of almost four months before any steps were taken under the authority granted by Congress. This delay, as it will be pointed out further on, was one of the causes for the mediocre efficaciousness of the program in its struggle against rising prices. Consultations did begin with a meeting held at the Federal Reserve Bank of New York on December 19, 1950. The meeting, attended by representatives of the American Bankers' Association, the Investment Bankers' Association of America, the Life Insurance Association of America, and by representatives of the Federal Reserve Bank of New York and the Board of Governors of the Federal Reserve System, was called by the President of the Federal Reserve Bank of New York at the request of the Board of Governors to discuss the possibility of voluntary agreements or programs to restrict the granting of credit not needed in the defense effort.[15]

The result was the appointment of a subcommittee consisting of two members of each association to be represented at the meeting. It was decided that, with aid of counsel for each of the groups, and with Federal Reserve assistance, recommendations with respect to a voluntary

[15] "First Annual Report of the Activities of the Joint Committee on Defense Production." Senate Report No. 1040, 1951, pp. 247-248.

program might be formulated. On the basis of those recommendations, the committee which originally met on December 19 approved a program for voluntary credit restraint at another meeting held February 2, 1951.[16]

This program was later approved by the Board of Governors which consulted with the Attorney General and the Chairman of the Federal Trade Commission as required by section 708 (c) of the Defense Production Act.[17] The purpose of this requirement was to get anti-trust immunity from the Justice Department for those financial institutions which were to participate under this program. The *Wall Street Journal* stated that the Board of Governors had some difficulty in getting Justice Department approval of such a voluntary credit restraint tool. The Journal also revealed that the Board of Governors refused to make public a letter from the Justice Department which reportedly promised anti-trust immunity. The article stated that the Federal Reserve said that the Justice Department was unwilling to have the letter released. Objection was said to be based on the fact that the most recent letter from Attorney General McGrath carried references to previous correspondence between the two agencies, and that publication of the last statement would only present "one side" of the situation and this would not have been to the satisfaction of the Justice Department

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[16] *Ibid.*

[17] *Ibid.*

according to the Board of Governors. However, Board Governor Powell emphasized that the Justice Department's letter was "very straight-forward" and gave "unqualified approval." Commenting on this, the Wall Street Journal said, "Failure to make the letter public, however, leaves unexplained the exact terms of the Justice Department's endorsement."[18] But, casting aside this flimsy comment which lacked any reliable proof, Justice Department approval was given in early March, and on the 9th of that month, the Board of Governors issued its "request." The Chairman of the Board of Governors, in a memorandum to all financing institutions, urged their cooperation with the program. Copies of the "Statement of Principles" and the "Request by the Board of Governors" were sent to 90,000 leaders of both financial institutions and political entities, ranging in size from small township mayors to state governors and federal officials, and requesting them "....to act and to refrain from acting, pursuant to and in accordance with provisions of the Program....."[19]

Statement of Principles. The agreement starts out by revealing one of the weaknesses of the program per se. It is shown that the program is addressed to only one limited source of inflationary pressure. "It is appropriate to point out that this Program of voluntary credit restraint does not have to do with such factors as inflationary lending

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[18] "Voluntary Credit Curb Plan Reported Backed by Justice Department." Wall Street Journal, 137:3, March 14, 1951.

[19] Federal Reserve Bulletin, 37:263-266, March, 1951.

by federal agencies, unnecessary spending, federal, state or local, and the wage-price spiral and other much more seriously contributing factors."[20]

The purposes of the program are found in a small paragraph at the beginning of the statement.

"It shall be the purpose of financing institutions to extend credit in such a way as to help maintain and increase the strength of the domestic economy through the restraint of inflationary tendencies and at the same time to help finance the defense program and the essential needs of agriculture, industry and commerce."[21] Thus, the program had a twofold duty. One, to help restrain inflation by limiting the expansion of credit, and two, to act as an allocation or rationing mechanism to see that the defense and the defense supporting credit demands received preference over the non-defense credit demands, and in so doing to help promote the defense effort.

Pointing out the difference between this voluntary control and the general and selective types of credit restraint the Federal Reserve stated:

> In contrast to general measures which influence the over-all supply of credit, and selective restraints which influence the demand for specific types of credit through regulation of loan terms and conditions, the Voluntary Credit Restraint Program seeks to direct the flow of credit away from nonessential and speculative uses by the voluntary action of lenders in approving or

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[20] Ibid.

[21] Ibid.

> disapproving applications for funds. To do this it has been necessary to have certain criteria that would be of aid in assessing objectively the merits of individual loan applications and proposed bond and stock offerings in relation to over-all economic conditions and requirements.[22]

In order to pursue this policy, it became the obligation of every financial institution which considered itself an advocate of this credit restraint technique to "....screen loan applications on the basis of their purpose, in addition to the usual tests of credit worthiness. The criterion for sound lending in a period of inflationary danger boils down to the following: Does it commensurately increase or maintain production, processing and distribution of essential goods and services?"[23] The lending institutions were to follow not only their own criterion for making loans but those under the "Statement of Principles" of the VCRP and the bulletins that were issued from time to time after the program was inaugurated. These bulletins and ancillary memoranda will be discussed in the following chapter.

To give the program a greater initial impetus, certain general guides were established from the beginning for the screening of loans by lenders.

Proper loans under the program were:

> 1. Loans for defense production, direct or indirect, including fuel, power and transportation.

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[22]"Voluntary Action to Help Curb Inflation." op. cit., p. 3.

[23]Federal Reserve Bulletin, 37:263-266, March, 1951.

2. Loans for the production, processing, and orderly distribution of agricultural and other staple products, including export and import as well as domestic, and of goods and services supplying the essential day-to-day needs of the country.

3. Loans to augment working capital where higher wages and prices of materials make such loans necessary to sustain essential production, processing or distribution services.

4. Loans to securities dealers in the normal conduct of their business or to them or others incidental to the flotation and distribution of securities where the money is being raised for any of the foregoing purposes.

This Program would not seek to restrict loans guaranteed or insured, or authorized as to purpose by a Government agency, on the theory that they should be restricted, in accordance with national policy, at the source of guaranty or authorization. Financing institutions would not be restricted in honoring previous commitments.[24]

Improper loans under the program were:

1. Loans to retire or acquire corporate equities in the hands of the public, including loans for the acquisition of existing companies or plants where no over-all increase of production would result.

2. Loans for speculative investments or purchases. The first test of speculation is whether the purchase is for any purpose other than use or distribution in the normal course of the borrower's business. The second test is whether the amounts involved are disproportionate to the borrower's normal business operations. This would include speculative expansion of real estate holdings or plant facilities as well as speculative accumulation of inventories in expectation of resale instead of use.

The foregoing principles should be applied in screening as to purpose on all loans or securities not covered by Regulation U or T.[25]

The "Principles" further stated that, "....financing institutions should not only observe the letter of the

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[24]*Ibid*.

[25]*Ibid*.

existing regulations....but should also apply to all their lending the spirit of these and such other regulations and guiding principles as the Government may from time to time announce in the fight against inflation."[26] It was also revealed that, "This program is necessarily very general in nature. It is a voluntary program to aid in the over-all efforts to restrain inflation. To be helpful, this program must rely on the good will of all financing institutions and the over-all intention to comply with its spirit."[27]

The voluntary basis of the program was delineated by several facts. First, lending institutions in the United States were not compelled to join the program. This is not to say that there was no influence placed upon them to get them to join in cooperation with the spirit and enthusiasm which was found in many sectors of the program. Many psychological and social pressures could be placed against recalcitrant financial leaders who were somewhat skeptical about the merits of the plan to help implement the defense effort.

> ....While neither the National Committee nor the regional committees have any authority to direct the policies of the cooperating finance institutions, they can and do exert considerable influence on the thinking and decisions of lending officers and upon prospective borrowers who know of the Program and are in sympathy with its principles and objectives.[28]

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[26] Ibid.

[27] Ibid.

[28] "Voluntary Action to Help Curb Inflation." loc. cit.

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> It should be emphasized that the Program is in every sense of the term a voluntary undertaking on the part of the financing institutions. Pursuant to the requirements of the Program, a member of the Board of Governors of the Federal Reserve System is Chairman of the National Committee and personnel from the various Federal Reserve Banks are members of most of the regional committees. The Federal Reserve System, however, does not impress its views upon the National or regional committees as to the types of loans that are appropriate or inappropriate under the circumstances, and undertakes no action to oblige lending institutions to participate in the Program.[29]

The Federal Reserve has repeatedly stated that the purpose of the presence of their officials on the National Committee and the regional subcommittees was to protect the public interest. By this, they meant that it was these officials' duty to see that there was no illegal anti-trust collusion or similar activity among the members of the many credit restraint bodies to the detriment of the general public. But one may raise the question concerning the relationship of the Federal Reserve officials to the other members of the various committees when the question of loan policy came before the credit restraint policy determining bodies. Did they remain mute at these times in the proceedings? Or, did they actively reveal their opinions and in turn those of the Federal Reserve? From pure conjecture on this writer's part, the answer to the latter question would be "yes!"

Third, and this was the strongest characteristic

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[29] Senate Document No. 123, Part 1, op. cit., p. 431.

which gave this program its voluntary characteristic, was the provision that the final decision as to whether a loan would have been granted or rejected, after the regional or National committees had rendered their opinions, rested solely with the lending institution itself.

> The plan is based on the premise that a substantial degree of cooperation can be obtained on a voluntary basis provided that: (a) the lending standards which lenders are asked to follow are realistic and appropriate to the economic environment; (b) such standards are nondiscriminatory as between borrowers of the same general class; and (c) participating financial institutions are fully informed as to the desirable lending standards.[30]

Procedure for Implementing the Program. The central coordinating organization in the program was the National Credit Restraint Committee, members of which were appointed by the Board of Governors of the Federal Reserve System. The National Committee was composed of four representatives from the commercial banks, four from the life insurance companies, four from the investment banks and two representatives from the savings and loan associations and two from the mutual savings banks, resulting in a National Committee of seventeen members counting Federal Reserve representative Oliver S. Powell. Members of the committee were selected so as to achieve representation from various geographic areas and from small, medium and large financing institutions. Additional members and alternates were designated by the Board of Governors of the Federal Reserve System. Governor Oliver S.

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[30] Ibid.

Powell of the Board of Governors was chairman from the program's beginning to its conclusion. Alternate chairman was George B. Vest, General Counsel of the Board. The National Committee avoided building up a large organization. It had no budget and relied almost entirely upon part time assistance of regular staff members of the Board of Governors.[31]

In order to give an idea of the type of banking and life insurance officials who composed the National Committee and what positions they held with their respective financial institutions and to see the composition of this committee, the make up of the National Committee as of March 14, 1951 is given below. It will be noted that the officials taking part in the program were high ranking officers of their own financial entities. Chairmen of the Board, Presidents, Vice Presidents and Partners were the predominant offices that the members of the National Committee held with their respective companies. This gave increased prestige and effectiveness to the VCRP.

National Committee[32]

Commercial Banks

George S. Moore, Vice President, the National City Bank, New York, New York.

Carlisle R. Davis, Vice President, State-Planters Bank and Trust Company, Richmond, Virginia.

Kenton R. Cravens, Vice President, Mercantile Commerce Bank and Trust Company, St. Louis, Missouri.

Everett D. Reese, President and Trust Officer, Park National Bank, Newark, Ohio.

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[31]*Ibid.*, p. 432.

[32]*Federal Reserve Bulletin,* 37:379-384, April, 1951.

Life Insurance Companies

George L. Harrison, Chairman, New York Life Insurance Company, New York, New York.

Carrol M. Shanks, President, Prudential Insurance Company of America, Newark, New Jersey.

E. B. Stevenson, Jr., Executive Vice President, National Life and Accident Insurance Company, Nashville, Tennessee.

Claude L. Benner, President, Continental American Life Insurance Company, Wilmington, Delaware.

Investment Banks

Lee M. Limbert, Vice President, Blyth and Company, Incorporated, New York, New York.

Rudolf Smutny, Partner, Salomon Brothers and Hutzler, New York, New York.

Francis Kernan, Partner, White, Weld and Company, New York, New York.

William K. Barclay, Jr., Partner, Stein Brothers and Boyce, Philadelphia, Pennsylvania.

Occasionally, due to circumstances, the composition of the National Committee changed its original membership. This included the addition and subtraction of alternates plus two more permanent members each from savings and loan associations and mutual savings banks.

Functions of the National Committee were as follows:[33]

> (a) With such assistance from the Board and the Federal Reserve Banks as may be necessary, distribute this statement of the Program, including the Statement of Principles, to financing institutions to such extent as may be deemed desirable in view of any distribution previously made;
>
> (b) Appoint the subcommittees....;
>
> (c) Meet for the purpose of considering the functioning of the Program, advising the Board with respect thereto, and suggesting for the consideration of the Board such changes in the Program, including the Statement of Principles, as may from time to time appear appropriate. Meetings of the Committee shall be held at the call of an official of the Federal Reserve System, designated by the Board; shall be under the chairmanship of such an official; and an agenda for such meetings shall be prepared by such an official. Full and complete minutes of each meeting shall be kept in the files of the Board available for public inspection.

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[33]Federal Reserve Bulletin, 37:263-266, March, 1951.

(d) Issue bulletins or memoranda from time to time to the subcommittees or to financing institutions regarding general matters relating to the Program and related credit problems, including statements implementing or clarifying the Statement of Principles, and describing the types of credits which in the Committee's opinion, should or should not be regarded as proper under the terms of the Program.

(e) Request the chairman of the Committee to designate an employee of the Board of Governors to serve as secretary. Such secretary, in consultation with the chairman of the Committee, is authorized to conduct correspondence on behalf of the Committee in conformity with actions taken by the Committee within the scope of the Program.

Regional or subcommittees played the key liaison position between lending institutions and the National Committee. Membership of these subcommittees was drawn from divergent geographic areas and from small, medium and large institutions. This was to give as broad a representation of varying viewpoints as possible and to carry back to the many regions the principles of the program in as unified a manner as possible. At the same time, it gave a feeling of membership to all institutions regardless of size and location. It will also be seen in the examples given below that these committees were developed from the same caliber of men as the National Committee. The number of subcommittees grew as the needs became evident, and by the end of 1951 there were 43 regional committees divided as follows: 19 for the commercial banks; 4 for the life insurance companies; 4 for the investment banks; 4 for the mutual savings banks and 12 for the savings and loan associations. A Federal Reserve Bank officer was a member of each subcommittee which had headquarters in a city in which there was located a Federal Reserve Bank or a branch bank thereof. The reason for the presence of these officials was stated: "Adequate safeguards were established by the Defense Production Act to assure that there would be no infringement of anti-trust statutes. A representative of the Federal Reserve System is present to represent the public interest in practically all regional or national meetings of those taking part in the Voluntary Credit Restraint Program....."[34] The reason given here may be true, but as it was stated above, in the writer's opinion, there was also the question of policy control on the part of the Federal Reserve.

An example of the membership of the different classes of regional committees is given below. This is for the same purposes stated above when the membership of the National Committee was presented. Because of the lack of space, only one committee is given for each class of financial institution.

Selected Regional Committees[35]

Twelfth District Commercial Banking Voluntary Credit Restraint Committee

E. C. Sammons, Chairman,
President, The United States National Bank of Portland, Portland, Oregon.

I. Warren Hellman,
President, Wells Fargo Bank and Union Trust Company, San Francisco, California.

Chester A. Rude,
Chairman, Executive Committee, Security-First National Bank of Los Angeles, Los Angeles, California.

James Lockhead,
President, American Trust Company, San Francisco, California.

F. A. Ferroggiaro,
Senior Vice Chairman of the Board, Bank of America National Trust and Savings Association, San Francisco, California.

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[34]"Voluntary Action to Help Curb Inflation." loc. cit.

[35]Federal Reserve Bulletin, 37:379-384, April, 1951.

Thomas F. Gleed,
President, Seattle-First National Bank, Seattle, Washington.
E. R. Millard,
Vice President, Federal Reserve Bank of San Francisco, San Francisco, California.

Mid-Western Insurance Voluntary Credit Restraint Committee
Robert B. Richardson, Chairman,
President, Western Life Insurance Co., Helena, Montana.
T. A. Phillips,
Chairman of the Board, Minnesota Mutual Life Insurance Co., St. Paul, Minnesota.
W. T. Grant,
Chairman, Business Men's Assurance Co. of America, Kansas City, Missouri.
Frank J. Travers,
Vice President, American United Life Insurance Co., Indianapolis, Indiana.
Willard N. Boyden,
Vice President, Continental Assurance Company, Chicago, Illinois.
A. L. Olson,
Vice President, Federal Reserve Bank of Chicago, Chicago, Illinois.

Southwestern Investment Banking Voluntary Credit Restraint Committee.
John H. Rauscher, Chairman,
Rauscher, Pierce and Co., Mercantile Bank Building, Dallas 1, Texas.
H. H. Dewar,
Dewar, Robertson and Pancoast, National Bank of Commerce Building, San Antonio 5, Texas.
William C. Jackson, Jr.
First Southwest Co., Mercantile Bank Bldg., Dallas 1, Texas.
Edward Rotan,
Rotan, Mosle and Moreland, 806 Rusk Ave., Houston 2, Texas.
W. D. Gentry,
First Vice President, Federal Reserve Bank of Dallas, Dallas, Texas.

Main functions of the regional committees were:

(a) The most important single function of the regional committees was to consider inquiries from financial institutions as to whether a particular application for credit was in accord with the standards or guides to lending policy set forth in the Statement of Principles, bulletins or memoranda of the National Committee.

(b) Regional committees maintained records of their actions and made reports to the National Committee showing the types of cases considered and the nature of the advice given in each instance. This information was later collated by the National Committee and digests of representative cases and opinions were distributed to the various regional committees for their information.

The first line of attack upon inflation by this credit restraint program was not found in the National Committee or in the various regional subcommittees, but in the thousands of financial institutions which were in direct contact with those potential borrowers whose credit demands would have been powerful forces behind increased inflation, if they had not been held in check by a program of this type. It urged financing institutions to screen loan applications not only on the credit worthiness of the borrower, but also on the basis of purpose for which the loan proceeds would be used. For some lenders this was a striking departure from customary practice under which no information was necessary as to the use of loan proceeds. Other lenders who had been obtaining such information used it as a factor in their appraisal of credit risk and not as a separate and special criterion in passing on a loan application. The lending institutions which worked under this voluntary credit restraint mechanism looked not only into the ability of the borrower to repay the loan but likewise at the standards set by the National and regional committees.

A large and perplexing problem in developing the program was that of trying to establish some useful, workable standards or bench marks for distinguishing between those purposes which were consistent with the program and those not consistent with its aims. Loans to finance defense production posed no problem since such credit needs had to be met even at the expense of inflation. In spite of the defense program, however, some 80 percent of the gross national product continued to go to the civilian sector of the economy, and this high civilian demand required substantial amounts of credit. In this civilian area of credit demand, the National Committee encountered the difficult task of trying to devise some standards for differentiating between essential production, which should have continued to receive financing, and nonessential activities, which could have been appropriately delayed.

> In coping with this problem of lending standards, the National Committee recognized that comprehensive and precise rules and regulations would not be consistent with the essential voluntary character of the program, and might well discourage many institutions from even attempting to participate. Consequently, it was deemed more appropriate to phrase the standards for extending credit in fairly broad terms, rather than to list a host of detailed and specific criteria for lending practice, and to rely upon the willingness of lending institutions to conform to the spirit of the program rather than to comply with numerous legalistic rules. Hence the lending standards set forth in the Statement of Principles and in the bulletins and memoranda of the National Committee are couched in fairly broad and general language.[36]

[36] Senate Document No. 123, Part 1, *op. cit.*, p. 434.

Governor Oliver S. Powell, chairman of the National Committee of the VCRP epitomized the function of the program and possibly one of the reasons for its implementation when he stated: "....This program is in essence nothing but enlistment of the collective horse sense of all kinds of lenders to sort out the kinds of credit which should have priority under today's conditions and in that way to avoid Government regimentation of credit which, at best, must be a clumsy affair....."[37]

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[37] Oliver S. Powell, "Restraints upon Credit." Commercial and Financial Chronicle, 173:10, May 10, 1951.

## CHAPTER IV

## THE VOLUNTARY CREDIT RESTRAINT PROGRAM IN ACTION

### 1. Issuance of the Bulletins

It was shown in Chapter III that the first basic function of this voluntary program for the control of credit expansion involved the review of the past and present general credit and inflationary conditions and the forecast as to future trends by the National Committee and its staff at numerous meetings called by this Committee. A second fundamental function was the promulgation of bulletins, memoranda and letters asking the thousands of financial institutions participating under the program to confine their lending policies to the principles and provisions of this voluntary program as stated in these bulletins, memoranda et cetera. In this respect, the regional committees were to act as a liaison team between the thousands of financial institutions and the National Committee. They interpreted the policy statements issued by the National Committee and answered inquiries from lending institutions or other germane matters in their regional areas. Thus, it can be said that the survey of the past and present and the prediction of the trends of the economic future - especially in matters pertaining to credit and inflation - and the issuance of bulletins and memoranda, were designed to promote the principles behind the program which were the primary and principal functions of the National Voluntary Credit Restraint Committee. In this chapter, then, there will be a general discussion centering around these important functions of the VCRP and its National Committee.

The National Committee held its initial meeting in Washington on March 14 and 15, 1951. The Committee reviewed various aspects of credit granted to private institutions in relation to commodity prices and the defense effort and work was started on organizing the regional or subcommittees. Also, the Committee reviewed the scope of banking, credit and other statistics then available to measure changes in credit conditions and the need for further statistics along those lines. The Committee felt that it would be desirable to send bulletins to the subcommittees from time to time on specific credit problems. To avoid delay while subcommittees were being organized, bulletins were mailed directly to the 90,000 private financing institutions in the United States.[1]

Bulletin No. 1. The first bulletin issued by the National Committee dealt with inventory accumulation. As it was pointed out in Chapter II, inventory accumulation financed mainly by bank credit was one of the stronger forces behind the spiraling prices in the Korean inflation, particularly in the two great spurts of inflation that occurred in that period and which were mentioned in Chapter II. "....Inventories continued to rise sharply through the early months of 1951 and were at extraordinary high levels in

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[1] Federal Reserve Bulletin, 37:379, April, 1951.

mid-March when the National Committee held its initial meeting and selected this area as the subject of its first Bulletin."[2] Between January and February, 1951, total manufacturing and trade inventories increased from 62.1 billion dollars to 63.4 billion dollars annually. During this same time period, total manufacturing and trade sales declined from 45.9 billion dollars in January to 44.8 billion dollars in February. This resulted in an increase in the ratio of inventories to sales from 1.35 in January to 1.41 in February of 1951.[3] But this February figure was still somewhat below a past average of 1.51 for inventories to sales. Since statistical data of this type are usually at least 30 days or more behind the time when they are first published, it can be assumed that the statistical figures that the National Committee was using in their review of the economic environment were those in the time period cited above. From these data, then, it can be seen that there was a short run potential trend in the direction of increased inventory accumulation as measured by historical comparison, since inventories were increasing while sales were declining. Part of the increase in inventory accumulation was due to a price phenomenon, since inventories are carried at book value. But nevertheless, there was other evidence of an

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[2]Ibid., Reprint, "Voluntary Action to Help Curb Inflation." November, 1951, pp. 4-5.

[3]Economic Report, January, 1952, p. 186.

expansion in the physical holding of inventories.

With this inventory trend confronting the National Committee plus the recollection that inventory accumulation, or the attempt to do so, had played such a predominant role in the two great spurts of inflation after the Korean outbreak, it thus became the paramount concern to the Committee membership that this problem should be the subject of the first bulletin of this new anti-inflationary technique in early 1951.

Bulletin No. 1 stated:

> Inventories in the United States, particularly at wholesale and retail establishments, are at peak levels even after allowance is made for the sharp increase in prices at which inventories are carried. An important part of this abnormal increase in inventories has been financed by borrowed money.
>
> Excess inventory accumulation has already contributed directly to the rise of wholesale and retail prices beyond any level justified by the supply situation. It obviously has created undue competition in scarce materials.
>
> In the light of the above, the Voluntary Credit Restraint Committee expressed the hope that all financing institutions would, in carrying out the terms of the Program
>
> (1) Refrain from financing inventory increases above normal levels relative to sales, or reasonable requirements by other conservative yardsticks,
>
> (2) Encourage borrowers who already have excess inventories to bring these commitments and inventory positions in line as promptly as is reasonably practical, thereby reducing the amount of credit being used in this manner.[4]

This bulletin was mailed to all 90,000 financial institutions on March 19, 1951. But as it will possibly be

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[4] _Federal Reserve Bulletin_, 37:379, April, 1951.

seen in the next chapter, the plea for credit restraint may have been too late in the struggle against the Korean inflationary pressures.

<u>Bulletin No. 2.</u> The next meeting of the National Voluntary Credit Restraint Committee, which resulted in the promulgation of the second bulletin as a primary function under this program, was held on April 18, 1951. The survey conducted by the Department of Commerce and the Securities and Exchange Commission during the first quarter of 1951, revealed that business concerns were anticipating expenditures on new plant and equipment of nearly 24 billion dollars during 1951. Such expenditures, if realized according to the survey, would have represented an increase of 11 percent from the seasonally adjusted annual rate in the fourth quarter of 1950, and would have been almost 25 percent above the previous all-time record of 19.2 billion dollars in 1948.

Anticipated increases from 1950-1951 in plant and equipment expenditures of major industries ranged from 45 percent in manufacturing to 10 percent in the commercial and miscellaneous group. Part of the anticipated increase in business capital outlays reflected higher prices rather than an increased physical volume. Estimates indicated however, that on an over-all basis the increase in physical volume of business capital formation would be as much as 20 percent.

On an over-all basis, it appeared at that time that defense or defense-supporting industries would account for perhaps half of the business plant and equipment expenditures anticipated for 1951. Thus, the other half of the anticipated expenditures for plant and equipment was intended for the non-defense area of the economy. Because of this, and the fact that the economy by this time was reaching its level of full employment for both men and resources, the National Committee issued its second bulletin pertaining to business capital expenditures. In making it public, the National Committee unanimously stated:

> American business concerns are currently planning to spend, and are spending, record sums for the enlargement and modernization of their facilities. According to a recent survey of business plans, outlays for new plant and equipment during 1951 may total 24 billion dollars, an increase of 29 percent from the 1950 level, nearly one-fourth greater than the previous peak expenditure of 19.2 billion in 1948, and three times the dollar expenditures in 1941.
>
> This huge expenditure for capital investment bids fair to exceed the total amount of savings, both corporate and individual, for the next twelve months. Perhaps some substitution of bank credit for savings will be necessary. But at a time like the present when materials and labor are scarce, it becomes imperative if we desire to curtail inflationary forces, that great care be exercised by financing institutions participating in the Voluntary Credit Restraint Program in extending credit for investment purposes where such an extension does not tend to increase output essential for the defense program.
>
> In nondefense industry, business savings, if not spent on plant and equipment, could be used as working capital to meet payrolls, carry inventories, and finance accounts of buyers of their products. This would reduce the need for bank loans and other credit.
>
> Roughly half of the anticipated capital expenditures of business concerns during 1951 may be classed as defense or defense supporting, with emphasis on the latter. Included in these categories are expansion of basic productive capacity in such manufacturing industries as steel, aluminum, and petroleum; additions to electric power generating and transmission facilities, and the purchase of additional rolling stock by the railroads. Every effort should be made to assure availability of materials, equipment, and financing essential to the completion of these projects.

On the other hand, approximately half of the capital expenditures planned by business for 1951 falls in a more or less indeterminate class so far as their relationship to the defense effort is concerned. Some are clearly nonessential and deferrable, while others border closely on the defense-supporting area. There is, for example, the 5.4 billion dollar capital expenditure anticipated by the commercial and miscellaneous group, a large part of which could undoubtedly be postponed without detriment to the defense effort and in the interest of reducing inflationary pressures and conserving labor and materials. Limitations on construction of specific types and governmental restrictions and allocations of materials should play a large part in curtailing some business plans for capital expenditures and in eliminating others. Thus the responsibility of financing institutions will be limited to those cases whose essentiality has not been predetermined by Government agencies.

Since it may be difficult in individual cases to differentiate essential from nonessential capital expenditures, as well as those which it would be desirable to postpone in the interest of longer run economic stability, certain tests are suggested to financing institutions cooperating in the Voluntary Credit Restraint Program in making financing decisions. Among the nonessential uses of long term financing that in the judgment of the Committee might be postponed to a more propitious time are those for such purposes as:

(1) Construction of facilities to improve the competitive position of an individual producer of nonessential goods.

(2) Expansion and modernization expenditures of concerns in distribution or service lines where the distribution or service is not defense supporting.

(3) Expansion and modernization programs for the manufacture of consumer goods not related to the defense effort.

Financing institutions are urged to give equal consideration to the needs of small as well as large business in screening applications for long term financing.[5]

The estimated survey by the Department of Commerce and the Securities and Exchange Commission of new plant and equipment expenditures of 24 billion dollars was too conservative by 5.6 billion dollars when the actual year-end figures for 1951 were tabulated.[6]

[5] Ibid., 37:495-496, May, 1951.

[6] Economic Report, January, 1953, p. 170.

Bulletin No. 3. It soon became evident to the National Committee members and its advisors, that if the program was to have any effectiveness as an anti-inflationary and defense effort supporting mechanism, that all important financial institutions of the economy must play their roles in carrying forth this program. And they, in turn, must comply with the general credit policy ramifications of the program. There could be no complete cooperation from one sector of the economy if another was granted freedom from the control of the program or given immunity privileges under this credit restraint technique. It will be pointed out later in this chapter that the failure to completely follow this principle, that no sector of the economy be granted privileged immunity, became a strong force in bringing about the termination of th e VCRP in early 1952.

Therefore, it became evident to the National Committee that the State and local governments too must be brought under the influence of this voluntary program. And yet at the same time, it must be remembered that certain Federal Government financial agencies were operating without being subject to the program, a fact which has been pointed out earlier in this paper. Bulletin No. 3, therefore, dealt with State and local government borrowing. The Committee, at its meeting of May 3, 1951, discussed the matter of State and local government finance. Since Korea, nearly 2 billion dollars of public securities had been raised by new money, in 1951 reaching an all time high approaching 22 billion dollars.[7]

[7]Federal Reserve Bulletin, 37:497-499, May, 1951.

Projects for expanding or modernizing municipally owned facilities constituted the major demand for public capital borrowing. Roads, schools, water systems, drainage and sewer projects and the like were the principal purposes.[8] In the majority of cases local governments can borrow only on the approval of the electorate. This means that long periods intervene between the first proposal and the final financing. In many cases funds had been authorized some time previous to finance projects that were just being put underway in 1951 or which were to be started shortly thereafter. Some projects which had voter approval before Korea, turned out to be underfinanced at the current prices and required additional financing if they were to be carried forward on the basis of original plans.[9] The Committee estimated that examination of these plans under the program of the VCRP would eliminate many nonessential loans and avoid more borrowing.[10]

In issuing its third bulletin, the National Committee pointed out an important source of nonessential inflationary credit expansion on the State level in the realm of veterans' bonus payments.

> Soldiers' bonus issues are inflationary under today's conditions. They add to the spending power of the public through the creation of credit. It would seem desirable to postpone such issues until a time when immediate purchasing power is needed to counteract unemployment and when it might be more beneficial to

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[8]Ibid.

[9]Ibid.

[10]Ibid.

> the veteran.
>
> Among the types of State and local government capital outlays for which, in the judgment of the Committee, the financing should be postponed are:
>
> (1) Replacement of any existing facilities that can continue to perform their function during the emergency period.
>
> (2) Construction of facilities of the types not recommended by the Defense Production Administration - such as recreational facilities and war memorials.
>
> (3) Acquisition of sites or rights-of-way not immediately needed.
>
> (4) Purchase of privately owned utilities by municipalities, which involves borrowing to replace equity capital.[11]

The bulletin went on to urge lenders to encourage State and local governments to balance their budgets. Borrowing in anticipation of taxes should be held to a minimum. Also, temporary borrowing for capital purposes, unless anticipating current revenues, should be judged by standards specified above for long term capital loans. Endorsement was given to the Wilson letter which is discussed below.

In strong support of Bulletin No. 3 and as a more or less reinforcement of it, Charles E. Wilson, Director of Defense Mobilization, sent a letter which was made public simultaneously with the publication of Bulletin No. 3, which went to the Governors of all states, mayors of major cities, and financial officials of principal counties and other political subdivisions. It urged compliance with the program in general, requesting that all expenditures of 1 million dollars or more receive the go-ahead sign from their regional subcommittees which had jurisdiction in the particular cases

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[11] *Ibid.*

which were subject to scrutiny by these voluntary credit control committees.[12]

Mr. Wilson, in his letter, gave particular emphasis to the State financial plans for soldiers' bonuses, war memorials and municipal recreational projects. These were definitely labeled as inflationary and not in accord with the principles of the VCRP as well as Bulletin No. 3 of the National Committee.

The letter from the Director of the Office of Defense Mobilization specifically stated:

> ....On behalf of our Government I ask you to postpone borrowing, no matter how worthwhile the purpose, if the project is postponable. While many municipal projects are urgent, others might be set back to a time when they would contribute to maintaining a high level of employment in a period of slack business. Soldiers' bonus payments, many war memorials and municipal recreational projects are but a few important examples of postponable projects which will serve the nation better at a future time.[13]

It went on to urge compliance with the program and requested that all expenditures of 1 million dollars or more receive the O.K. of the various committees involved under the program.

West Virginia Veterans' Bonus Case. The reason back of the great emphasis placed in Bulletin No. 3 and the Wilson letter, was based on the fact that, under the current economic conditions, the financing of veterans' bonus payments by State governments would be inflationary and contrary to the

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[12] *Ibid.*

[13] *Ibid.*

principles of the VCRP. It was pointed out that two states, West Virginia and Missouri, had scheduled bonus payments to be made in 1951. Prior to this, and by the end of 1949, Alaska and eighteen states had authorized the payment of about 2.6 billion dollars in bonuses to about 7.8 million living World War II veterans and survivors of deceased veterans.[14]

"By May VCR had grown strong enough to do battle with giants. The state of West Virginia announced it was ready to float $67,500,000 worth of bonds to finance a veterans bonus. If V.C.R. could secure deferral of so inflationary an adventure, other states might put off bonus plans of their own....."[15] The situation was both precarious and explosive, with the veterans' organizations ready to hoist any dissenter, and the sensitive states-righters ready to join in at the first evidence of "outside" interference.[16] But the National Committee stuck to its guns and issued Bulletin No. 3, which is presented above, along with the moral support of Charles E. Wilson's letter.

The outcry following the position held by the National Committee was "....the loudest that financial men had heard in many a year."[17] Some security dealers and politicians

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[14]Irving H. Siegel and Edgar Weinberg, "State Bonuses for Veterans." Journal of Political Economy, 58:70-74, Feb., 1950

[15]"The Bankers Do A Job." Fortune, 44:93-94+, Oct., 1951.

[16]Ibid.

[17]Ibid.

who stood to profit from the bonus payment declared that "....many of the West Virginia veterans had already spent their share of the bonus on cars, TV sets, and so on - a curious rationalization that suggested inflation control should always go to improvidence."[18] "The inflation occurred," one banker declared, "when the bonus was voted!"[19]

But none of this swayed the convictions of the National Credit Restraint Committee. When investment bankers submitted underwriting plans to the Eastern Investment Banking Voluntary Credit Restraint Committee, they were told the issue was not in keeping with the program. The Governor of West Virginia and his advisers, the tom-toms thumping in their ears, decided to go ahead anyway in a direct test of the strength of the VCRP's influence. Late in May, 1951, State authorities declared the bonus bond issue open for bids. "Not one was submitted. The nation's underwriters had collectively decided the credit restraint program was worth more than the half million dollars any one of them could have grossed."[20]

This victory of the VCRP over the State of West Virginia was a feather in the former's cap, but it will be seen later in this chapter that its triumph was short-lived. For the politicians in West Virginia did not give up the struggle at the first skirmish. Time to them, meant only

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[18]Ibid.

[19]Ibid.

[20]Ibid.

a regrouping of their forces.

California Bonus O.K.'d. The VCRP did not frown on all new veterans' benefit bonds, however. If the offering could qualify as noninflationary, it received approval. This is what the California bonus case indicated in June, 1951, when it received the O.K. for competitive bidding on 25 million dollars in new bonds issued under the state's Veterans' Bond Act of 1949.[21]

The distinction made between the California and the West Virginia cases was that the former's bonuses were more like loans, whereas the latter's were outright gifts. In the California instance, the money was used to help veterans buy homes and farms under a program which had been operating for the past 30 years. Each veteran had to pony up a 5 percent initial payment on a house or 10 percent on a farm. Limits of $10,000 on homes and $15,000 on farms were imposed and the veteran must undertake to pay his debt within 20 years, at 3 percent interest.[22]

> In the light of those terms, ODM ruled that California's bond issue was not inflationary. That was a sharp reveral of its thumbs down last spring on a proposed $67.5 million bonus bond issue by West Virginia. Reason for the West Virginia rejection: The money would have been a straight gift to veterans, putting money into circulation without any increase in productivity.[23]

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[21] "Veterans' Bond Issue in California O.K.'d." Business Week, July 14, 1951, p. 116.

[22] Ibid.

[23] Ibid.

The writer questions the position taken in these two cases by the VCRP that there was a basic distinction between the California bonus case and the West Virginia bonus case. Under the VCRP the difference between an inflationary loan and one which was not inflationary turned on two points. One, whether the loan was productive or non-productive and speculative, and, second, whether the loan proceeds would be spent to promote the defense and defense supporting areas of the economy or whether the proceeds would be spent in some non-defense civilian sectors of the economy. Point number one does not lend strength to the distinction between these two cases.

The West Virginia bonus proceeds were classified as a gift and it was prejudged that these veteran appreciation payments would go into the purchase of civilian consumer goods, e.g., clothing, beer, television sets, automobiles, et cetera. But it is impossible to draw a distinction between one or the other of these uses of the bonus proceeds by the gauge of productivity. Surely, the manufacture of beer, television receivers and automobiles can be classified as being just as productive as the use of funds to build urban residential homes and rural dwellings, outbuildings and the reclamation of farm land back to fertility. Thus the first yardstick cannot be used in the writer's opinion in the distinction between the West Virginia and California veterans bonus cases.

The second ruler may prove to have been the pivot upon which these two cases were decided. It may be much easier to defend the distinction between these two cases on the ground that the construction of farm and non-farm residential property contributed more directly to the defense effort, than the manufacture of consumer luxury goods. But still there was no way of knowing what the recipients of the West Virginia bonus payments would have done with their shares. Some might have made payments on essential real estate also. Some might have even purchased defense savings bonds, a purchase hard to classify as not contributing to the defense effort.

Bulletin No. 4. The role of voluntary action in supplementing and reenforcing selective restraint measures is particularly well illustrated by developments in the real estate mortgage credit area. In an effort to curb the rapid expansion of real estate mortgage credit, the Board of Governors of the Federal Reserve System, exercising the authority granted it by the Defense Production Act of 1950 and related executive order, issued with the concurrence of the Administrator of Housing and Home Finance Agency, its Regulation X, effective October 12, 1950. Simultaneously the Federal Housing Administration adapted their regulations to the new standards developed by the Board.

Establishment of these regulations, which applied to Government-guaranteed mortgages on new and existing houses, to non-Government-guaranteed, or conventional, mortgage loans on newly constructed houses and to loans on certain classes of commercial property, brought about a sharp decline in the number of new houses started in 1951. On the other hand, failure to include credit extended on conventional terms for the purchase of existing houses enhanced the competitive advantage of such properties in the real estate market, and in many cases their transfers were accompanied by an expansion of real estate mortgage debt which added to inflationary pressures.

The National Voluntary Credit Restraint Committee, in Bulletin No. 4, issued on June 6, 1951, and revised in some respects the following September 5, recommended that new conventional mortgage loans on existing one-to four-family residential units, together with other indebtedness outstanding on the property, should not exceed the limit which Regulation X imposed on new construction or a limit of two-thirds of the fair value of the property, whichever was greater. The Committee also recommended that loans on larger residential properties and on commercial, agricultural and industrial property should in most cases not exceed two-thirds of the fair value and should be made only if careful screening as to purpose indicates that they are in harmony with the Voluntary Credit Restraint Program.

Bulletin No. 4 issued at the June 6, 1951, meeting of the National Committee requested the following:

> 1. Loans on residential property (one- to four-family units). The Committee has been informed that most financing institutions are following conservative lending policies on existing residential properties (one-to four-family units). The Committee urges all financing institutions to follow such policies and in no case to make a loan on existing property in an amount which would cause the total amount of credit outstanding (primary and all other credit combined) with respect to the property or with

respect to the transaction to exceed the limits which Regulation X imposes as to new construction.

2. <u>Loans on agricultural property</u>. While the Committee recognizes that in some instances a ban on agricultural property may be in effect a loan on residential property, the Committee feels that normally such a loan falls in the category of a ban on commercial property (see Section 3 below), and the lender should be guided by the recommendations of that section, as to over-all credit limits and purposes.

3. <u>Loans on residential property</u> (more than four family units) <u>and on commercial property</u>. Loans on residential property (more than four family units) and loans on commercial property such as office buildings, stores, hotels, motels, motor courts, restaurants etc., should be screened as to purpose and the loan should not be made unless it is in harmony with the principles of the program. If the loan is to be made in connection with a sale of commercial or residential property a determination by the financing institution that the sale and the sale price are bona fide may constitute a sufficient screening of the loan. The Committee conceives that it is not the function of the Voluntary Credit Restraint Program to make the transfer of real estate impossible or impracticable, but rather to reduce inflationary pressures by limiting the amount of additional credit created in the process of real estate transfer.

Financing institutions are urged to limit a loan, on any type of property described in this section, whether or not a sale is involved, to an amount which would not cause the <u>total amount of credit outstanding</u> with respect to the property or with respect to the transaction to exceed 66 2/3 percent of the fair value of the property. Also, the Committee urges that financing institutions require an appropriate and substantial amortization of principal.

The Committee recognizes that hardship may arise where a 66 2/3 percent loan limitation would not be sound or equitable. Such cases would include a loan to finance the sale of property to close an estate or to pay estate taxes, the refinancing of a maturing mortgage, or the sale of property of a bankrupt company. The Committee makes no recommendations in such cases.

4. <u>Loans on industrial property</u>. Loans on industrial property should be screened as to purpose whether or not the loan is to be made in connection with a sale of real estate property. In this instance, however, there appears to be no need for a percentage limitation on the amount of the loan, since in the industrial field mortgage security usually is merely one of the factors considered by the lender in determining whether to make the loan and often bears comparatively little relation to the amount of the loan.

5. Sale-lease back arrangements. The Committee also urges financing institutions to recognize that in most instances a "sale-lease back" arrangement, whereby real property is purchased by a financing institution and leased to the vendor or his nominee, is a substitute for a form of financing and therefore comes within the Program and should be screened as to purpose.[24]

At mid-year, 1951, the National Committee issued two more bulletins.

Bulletin No. 5. On July 23, 1951, the National Committee in connection with its attempt to bring under the program all areas of credit expansion, expressed itself on the matter of foreign borrowings in United States' markets.

> As a result of inquiries from regional committees about the status of foreign borrowings in United States' markets, the National Voluntary Credit Restraint Committee has discussed the status of such borrowings under the Voluntary Credit Restraint Program.
>
> The Committee concluded that all such credit applications on behalf of foreign borrowers should be screened to the same extent, and with the same purpose tests, as comparable American credits.
>
> It may be difficult in some cases for financing institutions or Regional Committees to determine whether a proposed foreign credit would indirectly contribute to defense or other objectives of the United States Government. It will be particularly desirable, therefore, when foreign cases are submitted for review, that financing institutions submit full facts to enable a judgment as to purpose. In exceptional cases when a Regional Committee finds the facts available to it are inadequate to judge an application, the National Committee, if requested, will endeavor to obtain supplementary information from Government Agencies.[25]

Bulletin No. 6. The following day after Bulletin No. 5 had been issued, the National Committee in order to clear up some ambiguities as to the status of loans secured

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[24] Federal Reserve Bulletin, 37:752-753, July, 1951.

[25] Ibid., 37:938, August, 1951.

on listed securities (subject to Regulation U or T of the Board of Governors) and loans secured on unlisted securities issued Bulletin No. 6 in which it took the following position:

> The original Statement of Principles of the Program of Voluntary Credit Restraint provided that "the foregoing principles (the antispeculative provisions) should be applied in screening as to purpose on all loans and securities whether or not covered by Regulation U or T." The first amendment to the Statement of Principles deleted the phrase "whether or" from the Statement. This provision has been the subject of a number of inquiries. For example, the question has been raised as to whether a loan on securities not covered by Regulation U or T must be screened as to purpose even though the amount of credit advanced might be permissible under these regulations. Such an interpretation would appear to treat the loans secured by unlisted stocks more severely than those on listed (i.e., "registered") securities. In order to cure this ambiguity, the following principles are recommended for your guidance by the National Committee.
>
> (1) Loans on securities covered by Regulation U or T are basically for the purpose of purchasing or carrying listed securities. It is recommended, therefore, that all loans on securities for purchasing or carrying unlisted securities be presumed to be for a proper purpose if the amount of credit extended is no greater than that permitted in the case of listed securities by Regulation U or T.
>
> (2) Loans on securities, whether or not listed, but not for the purpose of purchasing or carrying securities, should be made only for purposes consistent with the principles of voluntary credit restraint.[26]

This was to be the last bulletin to deal with a specific area of credit demand under the voluntary program although amendments and revisions to the basic six bulletins were to follow, along with the promulgation of other ancillary memoranda.

## 2. Revisions of Certain Bulletins

Revision of Bulletin No. 4. At the September 5, 1951, meeting, the National Committee after surveying the

[26]Ibid.

real estate situation under its jurisdiction issued a revisal of Bulletin No. 4. The reason given for this change in the voluntary program's policy was that "....it developed that the provisions of the Bulletin were not being complied with in certain areas, that cooperating lenders were under substantial pressure from lenders operating outside the Program, and that some relaxation of the provisions governing the financing of 1-to 4-family unit residential properties was necessary in order to prevent a spreading disregard of the Program's lending standards in these areas....."[27]

The revised portion of Bulletin No. 4 read:

> The permanent financing of most new construction will continue to be governed by Regulation X as revised on September 1, 1951 to conform with the provisions of the recently enacted Defense Housing and Community Facilities and Services Act of 1951.
>
> Section 1 of Bulletin No. 4 is revised to recommend, in the case of loans on residential properties of one-to four-family units, that loans on existing properties should not exceed the limitations imposed by Regulation X or 66 2/3 percent of the fair value of the property, whichever is greater. This means that on properties the fair value of which is $16,700 or less, the recommended limitations are those imposed by Regulation X (all of which are above 66 2/3 percent); on properties the fair value of which is greater than $16,700, the limitation on borrowing is 66 2/3 percent. In all other respects Bulletin No. 4 remains unchanged.[28]

This was, of course, a retreat from the program's stronger position on real estate credit and points to a weakening of the credit restraint technique. Instead of

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[27] Senate Document No. 123, Part 1, pp. 436-437.

[28] Federal Reserve Bulletin, 37:1241, October, 1951.

tightening controls in the face of opposition, the National Committee loosened the policy requirements to prevent further disregard for the principles of the program by a larger number of financial leaders. The result was a setback in the effectiveness of the program.

But in spite of its retreat, the National Committee, at this same meeting, concluded that the Voluntary Credit Restraint Program was achieving significant results.[29] Feeling among committee members was that the inflation potential was still strong and that the program was still necessary. The reasons given for the then existing lull in inflationary pressures were: (1) improved military position in Korea, (2) some waning of war psychology, (3) decline in consumer demand, (4) abundant crops of important agricultural commodities, (5) increased taxes, (6) wage and price controls and (7) the great productive potential of America.[30] The consumer price index had increased by only 2.1 percentage points from March to September, 1951. In that same period, the wholesale price index had actually declined by 6.4 percentage points.

It was decided to issue a wider distribution of digests of the opinions of regional committees concerning specific loan cases which had baffled the financial officers of lending institutions participating under the credit restraint technique. "The National Committee....decided

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[29] Ibid., 37:1058-1060, September, 1951.

[30] Ibid.

that a wider distribution of these digests would contribute to a better understanding of the Program among financial institutions, the press and the public....."[31]

On September, 27, 1951, the National Committee announced that the National Fraternal Congress of America had joined in the voluntary credit control device. This organization, comprising the fraternal life insurance companies of America, pledged its and its members' support to the principles and policies of the program.[32]

<u>West Virginia Case Again</u>. The politicians in West Virginia who were concerned about their proposed veterans' bonus payment, which had been held in check in early spring, again began to generate trouble for the VCRP.

> The National Voluntary Credit Restraint Committee today conferred with Governor Okey L. Patteson of West Virginia and a delegation of West Virginia State and banking officials who had been invited to discuss their proposal to issue 75 million dollars in state bonds to finance bonus payments to veterans voted in the November 1950 elections. There was also some discussion of a somewhat similar situation in the State of Oregon where a veterans' bonus plan had also been approved by the voters.
>
> . . . . . . . . . . . . . . . . . . .
>
> In view of the fact that investment bankers in compliance with the VCRP have refrained from bidding on the pending issue of bonds the Governor of West Virginia proposes to offer these bonds to the public directly by placing them on sale through the banks of West Virginia. The plan contemplates that any bonds left unsold would be purchased by using various State trust funds, disposing of other obligations if necessary.[33]

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[31] <u>Ibid</u>.

[32] <u>Ibid</u>., 37:1241-1243, October, 1951.

[33] <u>Ibid</u>.

The National Committee expressed concern. There was no change in the position of either Governor Patteson or the Committee on this bonus issue as a result of the discussion at that meeting. But the final disposition of this controversy resulted in a tremendous blow to the effectiveness and pride of the VCRP as an anti-inflationary force. The Governor went ahead with his plan to disregard the VCRP and its principles and financed the bonus issue in his own manner. On November 26, 1951, $37,500,000 of the veterans' bonus bonds were offered to state and national banks throughout the State of West Virginia, both for their own and public purchase. On December 15, 1951, the State sold $30,622,000 of the bonds to public banks and other groups, taking the remaining $6,878,000 itself. In April, 1952, the State sold publicly $30,000,000 additional veterans bonds. This finished the second installment of $90,000,000 authorized.[34] The state and national banks of West Virginia and other financial groups which participated in the transaction did so in direct violation of their pledge under the VCRP, that is, if they had ever made such a pledge. So the case, which had been built up in commercial and financial periodicals as a great triumph for the VCRP in early 1951, turned out to be a colossal and embarrassing defeat by the end of that same year.

In mid-October, 1951, more than fifty National and regional committee members met to discuss the progress of the

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[34] Moody's Manual of Investments, Governments and Municipals, 1954, p. 1443.

program and some of its present problems. Among the subjects under consideration was a so called "leak in the dyke", "...through credit granted under Government programs in fields where private financing institutions are attempting to restrain unnecessary credit expansion....."[35] The problem of allowing the Federal Government to compete with private financial institutions that were attempting to follow anti-inflation policies in their credit control under the VCRP, was one of the "drawbacks" of this method of inflation restraint. Later it caused great resentment on the part of private financial institutions and was one of the forces which reduced to some degree, the effectiveness of the program.

Partial Digest of Opinions. At the September 5, 1951, meeting of the National Committee, it had been pointed out that there was a great need for the assemblage and dispersal of a digest of opinions rendered by regional committees on typical cases referred by lending institutions to their respective jurisdictional subcommittees. This procedure, it was felt, would lead to a greater strength for the program and a more comprehensive understanding by the public of its principles and policies, in addition to a more powerful diligence and sharper finesse in the operation of the subcommittees under the VCRP.

To fulfill this gap, the National Committee in conjunction with its regional cohorts digested and published in

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[35] Federal Reserve Bulletin, 37:1361, November, 1951.

the November, 1951, issue of the Federal Reserve Bulletin samples of cases which had raised doubts in the minds of lenders and which, therefore, had been referred to the regional committees. It was felt that these cases were typical and that they would serve as guides, or benchmarks, for similar ones that might arise in the future. It was also anticipated that potential borrowers would heed the implications of this digest of cases before approaching financial institutions for an extension of credit.

Given below is only a partial coverage of the published opinionated cases. They are presented here only for an expository purpose to demonstrate an ancillary technique of the VCRP in action. They have not been selected in any manner to slant or prejudice this paper. The digest was simply reduced for lack of space and to reduce boredom which is too easily entered into in a perusal of this paper.

Partial Digest of Opinions Rendered by Regional Committees on Typical Cases Referred by Lending Institutions Prior to Sept. 1, 1951.[36]

Seasonal and Inventory Loans

| Borrower and Purpose | Opinion |
|---|---|
| Wholesale seeds<br>To buy and clean seeds for resale to retailers of seed for use by farmers in necessary reseeding operations. | Favorable |
| Retail dry goods<br>For normal seasonal inventory acquisition | Favorable |

[36]Partial selection from digested cases published in Federal Reserve Bulletin, 37:1362-1365, November, 1951.

| Borrower and Purpose | Opinion |
|---|---|
| Retail hardware, lumber and building supplies<br>For normal inventory acquisition to care for summer and early fall trade | Favorable |
| Retail fuel oil<br>To purchase 1 million gallons of fuel oil (1/10 of annual volume) for storage and sale during the 1951-2 season | Favorable |
| Retail hardware<br>To enable borrower to carry inventory disproportionate to his normal business operations | Unfavorable |
| Retail sewing machine<br>To increase inventory of imported machines in anticipation of future curtailment in domestic manufacture of machines | Unfavorable |
| **Building Programs** | |
| Machine tool company<br>To build new plant to take care of present need. Present rental property too small and unsuitable for increased volume and employment | Favorable |
| Delicatessen<br>To build a new store building to serve a newly developed residential area | Favorable |
| Nursing home for aged<br>To buy existing building which is suitable for needed additional space for operations | Favorable |
| Retail farm tractor and implement dealer<br>To erect sales and service building in order to retain franchise | Unfavorable |
| Grain elevator and feed mill<br>To erect a new building to replace present facilities which are not very convenient from standpoint of services to customers | Unfavorable |
| Municipality<br>To erect agricultural-livestock exhibition building | Unfavorable |

## New Plant or Equipment

| Borrower and Purpose | Opinion |
|---|---|
| Publisher of daily newspaper<br>To purchase a printing press in<br>replacement of outmoded press which<br>does not take care of present re-<br>quirements | Favorable |
| Tankship owner<br>To purchase oil tanker for charter<br>to an oil company | Favorable |
| Excavating contractor<br>To purchase diesal tractor shovel<br>to replace worn and obsolete equip-<br>ment now in use | Favorable |
| Wholesale petroleum<br>To buy tractor-trailer units necessary<br>in operation | Favorable |
| Laundry<br>To purchase new machinery and<br>equipment for expansion of plant.<br>Deferrable unless program had been<br>started and commitments made prior<br>to inauguration of VCRP | Unfavorable |
| Social club and recreation center<br>To purchase bar and equipment<br>together with furnishings of social<br>room. Present facilities not<br>adequate | Unfavorable |

## Modernization

| Borrower and Purpose | Opinion |
|---|---|
| Farmer<br>To repair and remodel farm buildings<br>on 176 acre producing farm | Favorable |
| Retail variety store<br>For modernization and enlargement<br>of store building. Approval based<br>on facts that architect's plans<br>drawn and materials contracted for<br>prior to inception of VCRP | Favorable |
| Retail ladies ready-to-wear<br>To modernize store, add new<br>front and increase floor capacity<br>to maintain competitive position | Unfavorable |

| Borrower and Purpose | Opinion |
|---|---|
| Gasoline service station<br>For purchase and modernization of equipment and facilities of two existing gas stations | Unfavorable |
| **Working Capital Loans** | |
| Woodworking Mfg. of Bus. Fix. & Equip.<br>For necessary and normal working capital in connection with contract work in process | Favorable |
| Metal stamping plant<br>For necessary and normal working capital. Sixty-five percent of present volume is under defense contract | Favorable |
| Shoe manufacturer<br>For necessary and normal working capital | Favorable |
| **Debt Retirement and Refinancing** | |
| Retail automobile dealer<br>To repay existing bank loan | Favorable |
| Manufacturer of electrical appliances<br>For reduction of bank debt | Favorable |
| Retail milk dealer<br>To refinance existing indebtedness held by former owner of business | Unfavorable |
| Chain variety stores<br>To retire outstanding preferred stock | Unfavorable |
| **New Ventures** | |
| Retail grocer<br>To stock a new store to be opened in a new and expanding community now lacking a grocery | Favorable |
| Retail grocer<br>To stock a new grocery store which facilities appear not to be necessary in the community | Unfavorable |
| Dentist<br>To purchase furnishings and equipment necessary to operate a dental office. Borrower recently graduated from dental school | Favorable |

| Borrower and Purpose | Opinion |
| --- | --- |
| Amusement park<br>For erection of plant and purchase of equipment necessary for operations. Other amusement and recreational facilities are available in area | Unfavorable |
| **Other Loans** | |
| Housewife<br>To buy single premium life insurance contract. To provide for purchase of discounted premium life insurance contract | Unfavorable |
| Individual<br>To purchase real estate for investment. Property is already financed on a long-term basis. | Unfavorable |
| State government<br>For payment of bonus to veterans of World War II | Unfavorable |

In the last half of December, 1951, the financial institutions of America and the public were to witness two more revisions in the previously published bulletins of the VCRP.

Bulletin No. 2 Revised. The Voluntary Credit Restraint Committee reviewed the outlook for business spending on plant and equipment and revised the second bulletin previously issued. The general substance of this revision was:

1. The program should be continued under careful screening of all business capital financing programs. Business spending on plant and equipment is at record levels. Still shortages of basic materials exist. Demands for materials are still strong. The supply situation is likely to become worse before becoming better. Plant expansion for nondefense and nonessential purposes consumes scarce materials and

siphons off vital supplies. Such outlays have been large in 1951, but without the VCRP, they would have been substantially larger. "However, there will come a time when these non-defense plant expenditures will afford welcome support to business and employment. Business management and finance can jointly do a great public service both now and later by timing plant outlays and the financing thereof with full consideration of the foregoing facts."[37] (This was the first indication of a relaxing of the VCRP.)

2. The bulletin went on to point up the uses of funds which had a high priority under current conditions. They were: increasing capacity for the production of defense goods and of basic raw materials (such as metal and petroleum); loans to railroads and other public transportation, electric, gas and water utilities; loans under certain conditions to construction companies with bona fide contracts for the construction of defense facilities, highways, schools, port improvements, public utilities or railroads.[38]

3. Among long term nonessential uses of loans that should be postponed were: (1) construction of facilities to improve competitive conditions of nonessential goods; (2) expansion and modernization expenditures of concerns in distribution or service lines where the distribution or

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[37] Federal Reserve Bulletin, 38:22-24, January, 1952.

[38] Ibid.

service is not defense-supporting; (3) expansion and modernization of facilities not related to defense efforts and (4) purchase of existing plants or firms to improve the diversification of a company's products.[39]

4. The purpose for which funds will be used rather than the type of financing is the important point in screening loans under this program. Thus it was recommended that all types of security issues be screened - term loans, notes, debentures, bonds, preferred stock, common stock, sale-lease back arrangements or any other form of financing. Interim financing should be screened the same as final financing.[40]

5. There should be no discrimination between large and small business.[41]

6. Financing under this program should be screened even though the project has received a certificate of tax amortization, or has been allotted materials under the Controlled Materials Plan. But these certificates and allotments should be given consideration but not followed blindly. Screening under the program is welcomed by O.D.M.[42]

7. The absence of such certificates and allotments should not go against a request for a loan.[43]

In conjunction with the revised bulletin, a statement

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[39] Ibid.

[40] Ibid.

[41] Ibid.

[42] Ibid.

[43] Ibid.

was given of which the general gist is given in this paragraph. The general statement pointed out that business expenditures on plant and equipment in 1952 were expected to be as high as those of 1951. It pointed out that outside financing demand would be greater in 1952, than in 1951, because tax payments would be greater. In 1951, tax accruals ran in excess of liabilities, this was a source of short-term internal financing. The reverse was expected to occur in 1952. The statement further called for increased vigilance on the part of the VCRP in the sphere of government policy regarding plant expansion because the government, in its efforts to increase plant and equipment through subsidy and exploration contracts, had over extended its efforts. There may have been an "over allotting" of these incentives. Because of this, there was a need for the VCRP to scrutinize this government policy. Also premature financing increases the probability that funds may be diverted to other uses not related to the project, because of the shortage of materials.[44]

Bulletin No. 4 Amended Again. At the meeting of the National Committee on November 15, 1951, it was agreed that if the Board of Governors should decide to exempt leasing arrangements from Regulation X there should be an amendment of Bulletin No. 4, revised. Effective December 31, 1951, the Board amended Regulation X so that leasing arrangements involving new construction of commercial and industrial

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[44] *Ibid.*

property are no longer subject to that regulation. Therefore, the last paragraph of Bulletin No. 4 was amended to bring these leasing arrangements within its purview. The amended paragraph follows:

> 5. Leasing arrangements. The Committee also urges financing institutions to recognize that leasing arrangements sometimes are used as substitutes for mortgage financing and therefore come within the Program and should be screened as to purpose. This principle should apply to existing construction of all types and should also apply to new construction of commercial or involving commercial or industrial property no longer subject to Regulation X. Some examples of leasing arrangements which may be used as substitutes for mortgage credit and where, if this is the case, the above principle (i.e., screening as to purpose) should apply are sale-lease-back arrangements, long-term leases which may be renewed for a nominal rental, and leases in which the lessee has the right to have rental payments applied to the purchase price in a subsequent exercise of an option to buy the leased property.[45]

National Committee Memorandum to Subcommittees. By early February, 1952, it was still apparent that the Voluntary Credit Restraint Program was laboring under its stated principles and policies. This labor was due primarily to the overlapping of administrative jurisdictions and channels of communication. These problems could only rise to the surface after time and experience had proved the value of the credit restraining technique. Here is found another indication of the time required before a program of this type can reach a stage of effectiveness contra-inflation. It was actually another signpost that the VCRP might not be a useful tool in an emergency of sudden outbursts of upward spiraling prices similar to those that

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[45] *Ibid.*

shocked the American economy immediately after the outbreak of the Korean War. This administrative difficulty of the VCRP was evident from a memorandum of Chairman Powell, issued to the regional committees on February 5, 1952.

The general content of this memorandum is found here as:

Recommendations to Regional Committees[46]

1. Interim and Permanent Financing. If interim loans have been screened and permanent financing for the same project is of equal amount as the interim loan then further screening is not necessary. But if permanent financing to replace interim financing is somewhat larger in amount, then screening is necessary.

2. Direct or Private Placements. (1) When the intermediary in a loan proceeding is an investment banker, security dealer, or other financing institution; the intermediary should screen the loan. (2) Where there is no intermediary, it is the responsibility of investing institutions or agent-lender to screen the issue themselves. (3) If one financing institution has approved or gotten the approval from a regional committee, other institutions joining the group do not have to get the O.K. also.

3. Loans to Retire Stock. Reaffirmation of the original position that this was contrary to principles in the absence of extenuating circumstances.

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[46] *Ibid.*, 38:252-253, March, 1952.

4. Screening Foreign Borrowing. Screening should take place in the city in which the agent or principal underwriter is domiciled.

5. State and Local Interim Financing. Certain municipalities have been arranging interim financing. At a later date they have requested clearance of permanent financing on the grounds that inability to fund outstanding obligations would create undue hardship and embarrassment. Bulletin No. 3 specifically recommends that temporary borrowing for capital purposes, unless anticipating current revenues, should be judged by the standards specified for long term capital loans. The Bulletin also urges local governments to balance operating budgets and to hold borrowing in anticipation of taxes or other revenues to a minimum. Consequently, financing institutions are urged to assure themselves that interim financing by State and local governments is evaluated under the Program in the same manner and by the same standards as would be applicable in the case of long-term financing.

6. Transportation Equipment. The question has been raised with the National Committee whether loans for the purchase of transportation equipment already in use, i.e., ships, trucks, etc., were contrary to the principles of the program: answer, not in accord unless withdrawal of the equipment would impede the defense effort.

7. Temporary Real Estate Financing. Temporary credit can be granted where a home buyer cannot synchronize the sale of his old home and the purchase of a new home.

From February to the first half of March, there were no further public releases or utterances in relation to matters of public policy or to the effectiveness of the program as an anti-inflation tool.

### 3. Wane and Revocation of the VCRP

Fatal Blow Struck Against the VCRP. On March 24, 1952, President Truman transmitted through Charles E. Wilson a request that the VCRP suspend its screening of state and local government financing by the regional committees. The National Committee acted on March 28, 1952.

His reason is revealed in the letter itself:

> One feature of the program (VCRP) has, however, worried me from the start. That is the feature under which State and local governments were requested to submit their proposals for new financing to committees made up of private bankers and others in the private financial field for advice as to whether the financing should be undertaken during the present emergency.....
>
> This arrangement has meant, in effect, that the Federal Government has restricted the proposed actions of State and local governments in matters which should be decided, under our scheme of government, by State and local initiative..... I believe that the application of such an arrangement to the affairs of State and local governments should be continued no longer than is absolutely necessary.[47]

Evidently, the Chief Executive believed that the Federal Government had been encroaching upon the jurisdiction of the State and local political bodies. This may have been true, but in the light of the Truman political philosophy of Federal Government supremacy in the sphere of states' rights versus federal rights, his line of reasoning

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[47] *Ibid.*, 38:364, April, 1952.

appears strange to be coming from the principal proponent of the Fair Deal.

But, in the Journal of the American Bankers' Association, there was a more credible account of the forces behind the death of the VCRP. According to this source, the objection to the control that the VCRP had over State and local government financial matters did not emerge from the fact that the program had attempted to thrust aside certain veterans' bonus financial transactions, but the objection did arise when the VCRP stood in the way of the approval of a possible bond issue for the purchase by seven public utility districts in the states of Washington and Idaho of the Puget Sound Power and Light Company.[48]

Public power supporters were so opposed to the VCRP for standing in their way in the purchase of the already existing utility facilities that were in the hands of a private company - this transaction would have been clearly inflationary under the policy and principles of the VCRP - that it was originally planned by Senator Warren Magnuson (Dem., Wash.) that the Defense Production Act should be amended to remove State and local borrowing from the VCRP.[49] Public power advocates prevailed instead upon the White House to take this step without waiting for consideration of the Defense Production Act in June, 1952. The amendment

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[48]"Washington." Banking, 44:123-124, May, 1952.

[49]Ibid.

to the VCRP, which removed State and local governments from that anti-inflation mechanism's sphere of influence, was approved on April 11, 1952.

The article in the Journal of the American Bankers' Association went on to reveal the lending institutions' reaction to Presidential action and their reasons for failing to withdraw their support from the program although a strong blow had already been struck against its foundation; a blow which eventually led to the sudden death of the program.

> Notwithstanding the separation of state and local credit from the VCR Program, the program carries on. Several members of the national committee, as presumably also members of the regional committees, were disposed initially to resign in indignation over the President's action in discrimination in favor of public borrowing.
>
> Members were persuaded to retain their VCR committee membership and carry on with the VCR program for a time, with this theory more or less in mind:
>
> Private finance is notoriously subject to demagogic attacks. If private banking, insurance and investment, on their own initiative killed off the voluntary effort to curb the inflationary use by business of credit, then they would quickly be charged - should inflationary forces resume - with having failed to succeed with their own voluntary restraint program. There were many possibilities in the background among them that Congress might be disinclined to renew any material part of the Defense Production Act and its so-called "anti-inflation" program.
>
> On the other hand, always lurking in the background is the fact that the extreme radicals among the controllers sponsor the assumption by the administration of the power to ration credit in an inflationary era, through dusting off the Banking Act of 1933 and the Trading with the Enemy Act for this purpose.
>
> Actually officials were inclined to think the direct damage of releasing state and local borrowing was less material than the effect this action had in undermining the morale of the Voluntary Credit Restraint Program as a whole.[50]

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[50] Ibid.

Suspension of the VCRP. From the time that State and local governments were exempted from the VCRP by President Truman's order which "....brought immediate threats of resignation from members of the committee and led to suggestions that the whole idea be abandoned,"[51] the voluntary credit restraint mechanism had been on the skids. "Regional committees reported an increasing tendency for lenders to sidestep the loan review procedure."[52] It thus became evident that the lending institutions had begun to lose their enthusiasm for the program soon after the State and local political entities received their immunity from its controls. This was in keeping with the principle which was pointed out in the early pages of this chapter when Bulletin No. 3 was first discussed, that all important areas of credit and finance must be subjected to the program, or they would soon lose their enthusiasm for attaining the purposes behind the credit restraint technique.

On May 2, 1952, the National Committee made a request to the Board of Governors of the Federal Reserve System that the VCRP be suspended for the time being on a standby basis. The Board concurred unanimously on the recommendation of the National Committee and suspended the VCRP effective May 12, 1952.[53] The reason given for the suspension was "in the light of current circumstances." This was interpreted to mean that current inflationary forces had subsided for the

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[51]"Exit Credit Curbs." Business Week, May 10, 1952, p. 34.

[52]Ibid.

[53]Federal Reserve Bulletin, 38:501-502, May, 1952.

present time.

> At its Washington swan-song meeting, the national VCR committee said, "current circumstances" favored shutting down now. Basically, that meant inflation fires were burning low, credit was in better balance. That was all true. True, too, is the fact that the president had already kicked the props out from under VCR.....[54]

The inflationary situation in the first few months of 1952 as measured by the price indexes was rather uncertain. The wholesale price index which had been declining throughout 1951 continued to do just this in the early phases of 1952. In January the index for all commodities was 113, (1947-49=100), by May of that year it was down to 111.6.[55] On the other hand, the consumers' price index, all items, (1935-39=100), was less optimistic. This price index had been rising throughout 1951 and reached a high of 189.1 in January of 1952, but by February, 1952, it had dropped to 187.9. Yet the following two months, the index revealed that the inflation fires were not burning as low as was first thought. By May, 1952, the index had climbed back to 189.0.[56] From these basic indicators of the inflationary climate, it would seem that those officials whose duty it was to do all in their power to control or reduce the forces behind price rising trends, should have thought twice before they recommended the suspension of the VCRP. But in the light of the blow

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[54] "Exit Credit Curbs." loc. cit.

[55] Economic Report, January, 1953, p. 188.

[56] Ibid., p. 190.

struck at the foundation of the program by the removal of State and local government financial transactions from the program's jurisdiction, the officials may have had no choice left but to suspend the program in its entirety.

Repeal of the Voluntary Agreement Power. When the Defense Production Act came before Congress in June, 1952, the eve of its expiration date, many groups favored the extension of the power to enter into this voluntary agreement granted the thousands of financial institutions via Congress, the President and the Board of Governors of the Federal Reserve System, suggesting that the VCRP merely be suspended and retained on a standby basis in the event of an amergency. These groups included the National Voluntary Credit Restraint Committee, the Board of Governors and the American Bankers' Association.[57] But their pleas fell on deaf ears; the authority to enter into this voluntary scheme with anti-trust immunity was stricken from the Defense Production Act on June 30, 1952, when a somewhat weakened version of that act was amended, revised and extended by Congress. The Congressional action meant that if this type of anti-inflation technique was ever to be revised in the future there would have to be a period of organization and implementation such as that which occurred in the latter part of 1950 and early 1951 before this tool could ever become effective and puruse its purposes. It will be seen in the next chapter that this inherent characteristic is one of the basic weaknesses of the program per se.

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[57] See Banking, 44:38, June, 1952.

## CHAPTER V

## AN EVALUATION

### 1. General Introduction

The Voluntary Credit Restraint Program was a type of formalized moral suasion typified and incased in such language as: "requests the compliance in," "encourages the screening of," "asks the reliance on the good will of," "urges in the spirit of," and similar phrases which exemplified voluntary agreements of this caliber. The time has now come to attempt an evaluation of such a voluntary technique of credit and inflation control.

Difficulties in Making an Evaluation. In an attempt to evaluate the Voluntary Credit Restraint Program in its struggle against the inflationary forces from early 1951 to early 1952 and at the same time reveal its influence as a tool for channeling credit from the non-essential to the essential areas of economic activity, one is confronted by many difficulties in pursuing this task. One of the first stumbling blocks is the inherent characteristic of the VCRP per se. That is, the VCRP was basically a qualitative, rather than a quantitative, tool for controlling credit expansion in an inflationary period. It will be recalled that in Chapter III that this voluntary program was rightfully referred to as "formalized moral suasion". A true example of a qualitative credit control technique. It will also be remembered that the VCRP's duty was primarily that of channeling credit into the defense and defense supporting industries rather than determining how much credit ought to be allowed to industries in those classifications. The program, as such, was not directly preoccupied with the size of the inflation gap per se. A loan was considered to be proper and within the propriety of the program if the purpose, or purposes, for which the proceeds of it were to be used were within the proper confines of the program as delineated by the principles and policies found in the "Statement of Principles" and the bulletins and numerous memoranda promulgated by the National Committee. There were no ceiling quotas or rationings of credit in a quantitative sense with a consideration as to the amount of credit that should be allocated to the various industries and the economy as a whole.

This inherent characteristic of the VCRP and the point that it might possibly lead to certain difficulties were keenly observed at a meeting of the 3rd Federal Reserve District's Federal Reserve Relations Committee at a time when the VCRP was in effect. Vice President Karl Bopp of the 3rd Federal Reserve Bank was discussing this vital characteristic when he said:

> ....We should think in terms of total quantity as well as individual character. If a loan is to be made for a defense purpose the thing to do is to see where these funds are coming from, and to secure them from repayments on maturing loans, ordinary personal loans, ordinary business loans, and so on. The program arose because the volume of loans was expanding rapidly, and I think the criterion of this plan's [VCRP's] success ultimately will have to be quantitative. It will be

> successful if over-all we do not have an expansion as we may have in total production measured in real, not dollar, terms. We should remember, also, what Clay Anderson said about the velocity of circulation in this connection.
>
> What I would like to emphasize is the over-all quantitative problem. I think, therefore, that in addition to giving attention to the specific applications, we should pay attention to the loan total which the institution is making.[1]

But, the program never did treat the inflation problem in a quantitative sense. That is, there was no attempt to limit the total over-all amount of credit outstanding for the economy by this technique. This was left to the combination of general and selective types of credit containment. In other words, if the total amount of nonessential credit was completely eliminated, and all credit expansion was going exclusively to the defense and defense supporting industries of the economy and under these conditions inflation was still profusely evident, then, the VCRP would have made little contribution as an anti-inflation tool. For one of its two main policies was to provide all the credit demanded by the defense effort without any consideration for the quantitative aspects of such a policy. In this hypothetical example, the program's outlook would have been to avoid the greater of two evils. That is, the VCRP would have sacrificed inflation for defense rather than defense for stable price levels. This would have been a proper approach, but a more common sense value would have been to have defense and stable price levels together. Such

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[1]Remarks made at the 13th Session of the Federal Reserve Relations Committee of the 3rd District Federal Reserve Bank.

a goal would have been an impossible task for the program to accomplish by itself. Because of the qualitative character of the program, it has been difficult, if not impossible, to measure the effectiveness of this mechanism in a statistical or quantitative manner.

Another reason for the unreliability of various statistical studies concerning the value of this voluntary credit restraint technique is the fact that there was a multiplicity of various other credit control tools all wrestling in the same arena at the same moment with the same adversary. When one attempts to award the plaudits to a certain type of credit control for having adequately pinned its opponent's shoulders to the canvas for the three count, it is found that this is impossible because the actual struggle has turned out to be a team match. The award can only be granted to the team as a whole. It becomes next to impossible to single out each member of the team for special citations. The quantitative indicators of economic activity have not attained the accuracy which allows them to focus on each control device in a time of inflation and come to precise evaluations about these tools. For example, in the field of real estate credit control - assuming that it was controlled to some extent - it is impossible to say that the reduction in real estate credit expansion was due exclusively or proportionally to Regulation X, a selective control; to the general controls of reserve requirement and discount rate manipulations or to the qualitative aspects of the VCRP. This is because all three of these types of credit restraint were active in this area of inflationary pressures at the same time. The social scientist is handicapped in this respect, because he does not have the use of the experimental vacuum which the natural scientist can use in his search for truth. This tool gives a great advantage to the natural scientist, for he can use controlled experiments dealing with large numbers and determine the effects of various forces upon the subject under study and come to fairly accurate conclusions. The use of the vacuum in experiments in the social sciences is practically impossible. The human factor is always present; individuals pride themselves on certain freedoms and any attempt to convert them into guinea pigs would be a direct affront to human pride and dignity.

A third condition which made it difficult to arrive at any definite conclusions as to the worth of the Voluntary Credit Restraint Program was the fact that the economy had not been forced by the Korean War to the extreme predicament of being thrust into a total war economy. The Korean outbreak was a part of the cold war state that still exists to date. This fact has great bearing on the matter of evaluation since one of the VCRP's main functions was to allocate credit from the nonessential industries to the essential defense and defense-supporting industries. The institutions working under this program found great difficulty in distinguishing between what was essential credit and what was nonessential. This difficulty was exemplified by the necessity for the issuance of ancillary bulletins, and the fact pointed out in Chapter IV that even after almost a year's experience, the VCRP was still having administrative difficulties caused by the predicament of distinguishing between essential and nonessential credit uses. Thus, if these lending institutions found this distinction between essential and nonessential purposes perplexing, then, anyone attempting to arrive at an evaluation of the program would certainly encounter such a problem also. Halfway efforts are usually more difficult in matters of human relations than all-out efforts. The former requires skill in judgment and moderation as to the amount of endeavor needed, whereas, the latter requires only the maximum force with no brakes applied. The path of moderation is a difficult one to travel.

Some of these points were revealed in the reply of Federal Reserve Bank presidents in a request for their evaluation of the program.

> It is very difficult, if not impossible, to appraise statistically the effect of a single instrument of credit control, such as the voluntary credit-restraint program, because of the multiplicity of factors and the cross-currents which influence the demand for bank credit and its availability. Moreover, there is no statistical way of ascertaining what the amount of outstanding bank credit would have been during any given period if particular credit-control instruments had not been in effect.[2]

Another point which directly bears on this question of the difficulty of evaluating the VCRP is that there was no method of quantifying the number of loans "nipped in the bud." By this phrase it is meant that the psychological effect

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[2]Senate Document, No. 123, Part 2, pp. 714-715.

of the program itself caused certain potential borrowers to hold back their demands for credit extension at their own initiative. This self restraining influence of the VCRP cannot be measured in any quantitative sense because of the impossibility of gathering this data.

Another point which has been stated previously in other chapters of this paper is the influence of the Treasury-Federal Reserve accord. This agreement has been explained in some detail in regard to its ramifications as an anti-inflation step on the part of these two institutions. It should be shown that this accord was entered into at approximately the same time that the voluntary program was initiated. This fact further complicates the matter of evaluating the latter anti-inflation technique. When statistics reveal that the upward price spiral began to subside in March, 1951, the same period that the accord was entered into and the inauguration of the VCRP was established, it becomes difficult if not impossible to determine the effectiveness of either of these two counter inflationary steps. But, it will be seen later that in the opinions of certain groups with specific financial interests that the accord played a substantial role in the war upon inflation.

Further, it should be revealed that in early 1951 there occurred a lull in the inflationary pressures in the economy. This was the result of a saturated consumer demand for durable goods and the excessive accumulation of inventories by businessmen. Advocates of the VCRP would like to credit this lull in the inflation to the VCRP, but in view of the facts cited above and the fact that this voluntary program was just getting under-way make this position a dubious position to defend.

Initial Skepticism. Before entering into the more detailed phases of the evaluation found in this chapter, it may prove worthwhile to give a few insights into the climate of anticipated effectiveness regarding the VCRP that existed when this tool was thrust into its initial stages of conception. John D. Clark, a member of the Council of Economic Advisers, cooked up a plan in March, 1951, that would have frozen bank loans at a stated sum for 30 days. Then, a thaw would begin with loans outstanding held to a maximum in relation to previous months or some other similar base period. It was said that no Congressional approval would be necessary for implementing this plan. The President had the power to initiate this scheme by declaring an "emergency" under the Banking Act of 1933 and the Trading with the Enemy Act. Of course, one of the meanings behind the open discussion of this plan was its use as a tool to control inflation, but its public discussion also had other implications. One was that it presented a challenge or threat to those working under the VCRP to either make this program effective or suffer the consequences of stronger and more rigid controls. A second implication was that certain political groups held a partial skepticism in regards to the success of the VCRP. The Federal Reserve System as expected was opposed to this credit freeze device. The Treasury was cagey as usual. It gave only cautious approval, with a reserve thought that the plan be invoked only after the voluntary curb on credit had been given a chance to succeed or fail. Because of this, the VCRP was placed temporarily on trial by many skeptics. Actually for the economy in general, these stronger plans did not have to be placed into commission, not because the voluntary mechanism was an overwhelming success, but because the inflationary forces by mid-year, 1951, had subsided greatly from the second half, 1950, hyper-state of strength.[3]

At that same time, in Chicago, Federal Reserve Governor R. M. Evans was telling his audience that, "the voluntary plan was no substitute for the additional authority the board needs to hold down credit."[4] That additional authority which was thought to be necessary was a secondary reserve plan for the commercial banks, but which never materialized as an additional tool of inflation control. This was possibly due to the accord which had been reached between the Federal Reserve and the Treasury and other economic trends which were beginning to be felt in the encounter vis a vis inflation. This brief discussion gives some idea of the skeptical outlook in regards to the anticipated success of the VCRP that existed in early 1951.

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[3]"Planners Ponder Roof on Bank's Lending if 'Voluntary' Curb Fails." Wall Street Journal, 137:1, March 17, 1951.

[4]Ibid.

## 2. Influential Conditions, Advantages and Disadvantages

<u>Conditions Which Influenced VCRP's Effectiveness</u>. One of the purposes behind the writing of this paper was to point up certain conditions - some inherent and permanent - some transitional and temporary - which had important bearing upon the usefulness or value of this voluntary credit control mechanism. Certain conditions, both in the economy as a whole and as characteristics of the program per se, have been forces which enhanced the effectiveness of the credit restraint program. On the other hand certain other circumstances played just the opposite role and had a maleficent effect upon the VCRP. Listed below are some of the conditions and circumstances which influenced both sides in the evaluation of the voluntary credit curb.

1. The American economy is characterized by many thousands of financial institutions. The VCRP is said to have included among its adherents 90,000 financial institutions listed on the Federal Reserve's publications mailing list. This list includes 14,000 commercial banks, 3,000 investment banks, security dealers and brokers, 400 life insurance companies and 72,600 savings and loan associations, savings banks and other minor financial institutions. These institutions are of many varying sizes from gigantic city commercial banks, investment houses and nation-wide insurance firms to small rural banks, small town security dealers et cetera. They are spread over a vast geographical area; one of the largest industrially and financially developed countries in the world.

Yet, even with modern techniques of communication and transportation, certain areas in this vast continental country are bound to develop their own idiosyncrasies, concepts of responsibility, justice and feelings of membership. Because of this characteristic of vastness brought about by the large number of financial institutions in this country and their geographical location and disbursement, a program of this voluntary type depending upon the voluntary cooperation of thousands of private institutions to interpret and respond in a similar manner to requests stated in general language, was bound to result in a state of mediocrity. This was one of the drawbacks to the VCRP. If the American economy had been analagous to certain European economies where the financial and credit institutions are concentrated and few in number, then a voluntary program of this nature could have been more effective in the latter environment. Cooperation and compliance with certain policies is found to be much stronger in a small closely knit group than in a large group with a multiplicity of members loosely connected over a vast geographic space. Because of such conditions found in the financial sphere of the American business world, voluntary schemes like the VCRP will suffer greatly from this inherent characteristic of the American economy.

2. A second condition, which is debatable from both poles of the argument, is whether a voluntary program similar to the one under study here is more forceful in a climate of weak inflation pressures or in a climate of strong, hyper-inflationary forces. An advocate of the first position in

this argument states:

> Voluntary controls would be adequate under certain conditions: (1) if the shortage happened to be temporary, as might occur when demand had been abnormal because of unusual factors or when planned increases in production, once they became available, would make the total supply adequate; (2) if production and use happened to be concentrated in a relatively few companies.....[5]

The argument further states that voluntary controls are of no use when the going gets rough and the game gets tough because the pressures to disregard voluntary schemes of restraint are too powerful for such a loosely knit device as a VCRP to control.

The other position in this polemic is taken by those who believe that voluntary controls are useful only when the heat is on; when inflation has reached its hyper-state. The reasons given are that these stronger conditions of inflation are necessary to arouse the enthusiasm and interest of those taking part in the voluntary effort. They argue that an inflation of the "creeping variety" is too lifeless and drab to bring forth the interest necessary to keep a voluntary program alive. "Creeping inflation" tends to be discounted and accepted as a normal condition if it is allowed to exist for any length of time. It lulls men's minds to Morpheus. Also, the "intentional" or "creeping inflation" advocated by the "inflationists" as a tool or policy for keeping the economy on an even keel by making it

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[5]Ernest A. Tupper, "Guideposts to Industrial Mobilization." Harvard Business Review, 28:38, November, 1950.

possible for business entities to realize inventory profits which in turn are designed to lead to investment, employment and prosperity, is not intended to be controlled. It is induced for a purpose. To control it, would inhibit the attainment of this purpose of economic stability.

3. A condition which is important to a voluntary credit restraint mechanism is that the inflationary pressures must arise in part primarily from the credit sectors of the economy. That is, the inflation must be a credit inflation. It would be foolish and useless to attempt to control an inflation of the price-wage spiral type with credit restraining mechanisms. But this is not to say that an inflation of the price-wage spiral variety may not set into motion a secondary credit inflation growing out of the price-wage spiral which would then demand credit restraining gears. This problem has to be approached in a pragmatic manner. The Korean inflation was propelled mainly at first by the exogenous factors of the Communist invasion which led to scare buying and inventory accumulation. This, in turn, resulted in a large expansion of consumer credit and an increase in consumer and business dissaving which eventually led to a credit inflation. That type of inflation was later accompanied by a price-wage spiral phenomenon. Thus, in this light, the utilization of the VCRP was a proper step.

4. A fourth condition, which is important to the success of a voluntary plan, and as a matter of fact most any inflation controlling tool if it is to result in its greatest effort, is that the voluntary mechanism must be in

the hands of the administrative officials on a stand-by basis ready to be placed into effect at a moment's notice. Any controlling tool cannot give its greatest effort if there is a time lag great enough to allow prices, wages and costs to rise out of sight before the controls can be placed into use. This has been a characteristic of the post World War II cold war economy which played havoc with the average American's standard of living. Here, the VCRP is again subject to criticism, because the program was not at the onset of the Korean inflation nor is it at the moment even near to being on a stand-by basis. As it was shown in the last chapter, the group interests which had a keen enthusiasm about the merits of the program felt that it ought to have been suspended on a stand-by basis, but these requests fell on sealed ears.

5. An important condition which at first greatly enhanced the VCRP and which later partially led to its downfall was clearly expounded upon in the last chapter. This is the principle that under a voluntary program all sectors of the economy subject to the policies and principles of the credit curb must be treated on a fair and equitable basis. Or else, if there is allowed to exist a privileged few, then there soon will arise a resentment and a feeling of non-membership or inferiority on the part of those still subject to the program's control. This will possibly result in dissension among the ranks and eventual collapse of the whole voluntary effort. This was clearly demonstrated in Chapter IV by the State and local governments' relationship

to the VCRP in early 1951 when the voluntary program was accepted and became effective in this area. But in early 1952, when just the opposite resulted because of the failure to follow this doctrine of no privileged immunity, the VCRP then began to lose its strength and soon failed.

6. A sixth and important point which directly relates to the evaluation of this program centers around the question of the types of credit that the VCRP was designed to control. It can be readily seen that this credit control curb was solely concerned with inflation stemming from external sources of investment funds. These sources of external credit are the commercial banks, investment banks, life insurance companies and the savings and loan associations and savings banks; the very financial institutions that the VCRP sought to influence under its voluntary technique. And yet, when an inquiry is made into the ratio of these external sources of credit to the internal sources of credit that American business enterprises have been tapping, an important fact is revealed. Of the total sources of corporate investment funds, internal sources of corporate funds have run well over one-half of all sources, excluding sources from banks and life insurance companies.[6] Thus, since the VCRP was primarily intended to prevent inflation arising from external sources of credit expansion rather than internal sources, and since more than half of the corporate funds - excluding that from banks and life insurance companies - were obtained from internal sources from 1946 to and including

[6]Economic Report, January, 1954, p. 217.

the period in which the VCRP was in use; then, this fact greatly reduces the propriety and value in using such a credit control tool. But it should be remembered that the data cited here did not include non-corporate financing and sources of corporate and non-corporate funds obtained from banks and insurance companies. ?

7. The last point which will be discussed here is that a voluntary program such as the VCRP can only act as a supplement to other general and selective types of credit restraint tools. A program of such voluntary nature cannot be expected to stand alone and to offer a front line attack upon the evils of upward spiraling prices. Selective controls such as Regulations W, X, T or U are designed to operate in one specific area of credit restraint alone. Each is designed to fulfill a particular job. The Board of Governors in reply to a questionnaire of the Patman Subcommittee on General Credit Control and Debt Management has pointed up some of the difficulties of these types of selective controls.

> The comparatively favorable experience of the Federal Reserve System in administering selective regulation in the areas of stock market credit, consumer credit, and real estate credit is unique..... The general history of other attempts to restrain inflationary credit expansion through regulation of the amount of funds that may be loaned on particular transactions or through imposition of ceilings on particular categories of credit, either in this country or abroad, has not been such as to engender great faith in their efficacy. Reasons why these methods have usually failed in effectiveness include, among others, the fluidity of the credit market, availability of alternative sources of funds, the ability to substitute collateral, and the difficulty - amounting in many credit areas almost to impossibility - of drafting and administering regulations

which will accomplish their anti-inflationary objective, i.e. to restrain credit expansion without at the same time hampering unduly extensions of credit essential to the functioning of the economy.

To be effective, selective regulations of credit must relate to an area which is reasonably definable in terms of such things as the purpose of the credit, the collateral for it, or the nature of the credit contract. Trade practices should be specialized and sufficiently standardized so that the regulation can be applied in terms of a continuation or extension of those procedures rather than a drastic disruption of them.

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These tests are especially difficult to apply when the borrower is a business, and as such is engaged in a variety of simultaneous and interrelated operations that employ substantial amounts of credit for varied purposes - for example, to meet payrolls, to acquire inventory, to extend credit to customers, to pay dividends, or expand plant. Moreover, businesses have a variety of sources of funds as well as a variety of bases on which they may borrow..... Specialized and standardized lending practices are not adaptable to such credit, but rather loans are closely related to the lender's appraisal as to the borrower's general credit-worthiness with terms and conditions tailored to fit the individual borrower's needs. To apply selective credit regulation in such an area it would be necessary to impose standard credit terms and procedures in a manner which would be especially burdensome and disrupting to both lenders and borrowers.[7]

In giving an evaluation of the VCRP, the Board of Governors has pointed to the contribution that this voluntary effort has made in the way of supplementing and reinforcing the selective credit controls mentioned above and removing some of the difficulties that these credit tools have labored under from time to time.

....Its [VCRP's] major contribution has been in types of lending which are not well suited to the use of selective credit regulation. ....there are large areas of financing in which selective credit regulation is neither feasible nor practicable. These areas include

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[7]Senate Document, No. 123, Part 1, pp. 403-404.

> for example, short-and long-term financing by business concerns for which the multi-purpose uses of loan proceeds, as well as the varied terms and conditions under which such funds are obtained would pose difficult problems of administrative definition and compliance. In such areas, the Program has been a most useful restraining influence.[8]

In any discussion of the program certain over-all general advantages and disadvantages should be brought forth also. Some have been mentioned previously in relation to other matters. But a repetition here will not be too superfluous.

<u>General Advantages of the VCRP</u>. 1. In a nation in which businessmen value highly their rights to make their own business decisions, a program of the voluntary character of the VCRP is more acceptable to this class of the economy.

2. The VCRP has a selective character that mandatory schemes lack. The policies and principles of the program can be narrowed in their application as the economic conditions of the time demand.

3. Voluntary campaigns for credit control have a flexibility difficult to achieve in direct mandatory controls of lending. They can be adjusted to reflect conditions among the several kinds of lending institutions. The lending criteria can be quickly and easily altered to meet changing conditions.

4. The VCRP besides having the credit restraining influences also carries other psychological and educational stimuli. The program made the financial interests of the country conscious of their duty in the defense effort. There

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[8] Ibid., p. 438.

is no quantitative way of knowing how much credit expansion was turned down at the source of the demand, by the psychological and educational forces of this program, but certainly recognition must be made of this important influence.

General Disadvantages of the VCRP. 1. The main weakness lies in the very voluntary nature of the program itself. There was no assurance that all the financial institutions were willing to cooperate. The general character and language of the standards left room for differences of interpretation which inhibited the effectiveness of the program.

2. Any attempt to "enforce" cooperation may have led to monopolistic misuses of the voluntary campaign or to discrimination against certain borrowers.

3. The fact that there was constant friction between public and private financial institutions and that if a borrower was refused credit in the latter sphere because of the VCRP's policies, he might turn to the former sphere and receive his credit extension since many of these public institutions were exempt from the voluntary program's jurisdictions. All these factors led to a weakening of this program.

4. Every voluntary effort runs into the difficulty that it is likely to lose its force after some time unless it is institutionalized. It is not easy over a long period to maintain enthusiasm in restricting profit-making activities. It is, of course, most difficult to maintain enthusiasm if it turns out that some lenders disregard the program and

secure a great deal of new business at the cost of those who are cooperative.

5. Instead of tightening the regulations when there was evidence of non-cooperation, this voluntary program could only loosen the strings in hopes of preventing further non-cooperation. This was exemplified by the issuance and revisions of the real estate bulletins which has been previously referred to in Chapter IV.

6. The doctrine of "the sanctity of contract" which has long been accepted in the English and American law as being a valid and just rule of law prevented the VCRP from fulfilling a greater achievement. This was revealed by the case of the life insurance companies. Because these financial concerns had entered contracts in advance to supply funds to their various borrowers, these credit commitments first had to be worked off before the policies of the VCRP could become effective as an anti-inflationary tool in this area. This took from six to twelve months, greatly nullifying the initial effectiveness of this voluntary curb.

7. There is also the psychological factor which characterizes most voluntary programs composed of many thousands of members. This characteristic is the lack of perfect knowledge or the presence of imperfect knowledge due to poor or the complete absence of communication between the members of such a voluntary plan. Any single institution cannot definitely know that the other thousands of institutions are fulfilling their voluntary obligations in following the

policies of such a program. The presence of imperfect knowledge then creates suspicions and fears in the minds of the officials of the individual institutions which make up the membership of the program. From this relationship, then, there arises a psychological state of distrust on the institutional level, which eventually may lead to non-compliance with the entire policies of the program. The feeling is that such and such institution is not obeying the principles of the voluntary scheme, so why should our institution be subject to such policy ramifications. This type of thinking multiplied by all or a major part of the membership of the program soon culminates in complete collapse of this type of control altogether. This condition under which the VCRP operated is analagous to certain basic characteristics found in economic theory. It is known that under the oligopolistic form of industry organization there exists almost perfect knowledge because of the small number of members in the industry. But under pure competition, the fact that the industry is composed of a multiplicity of members means that there cannot exist perfect knowledge. Thus voluntary agreements in a pure competitive industry cannot be too effective. This is not to say that the financial industries in the United States are organized on a pure competitive basis. But due to the thousands of institutions in these industries, imperfect knowledge does exist. This condition inhibited the VCRP from being a primary force against inflation.

### 3. Opinions

If there is one thing that the VCRP can boast of having, it is a goodly supply of opinionated support. Everyone connected with the program and those with only a slight acquaintance were willing to express themselves favorably on the scheme. The evaluation of the voluntary technique can be concisely described as being long on favorable opinions but too short on statistical data to give strength to these opinions. Everywhere one searches for material to use in evaluation purposes he encounters the same familiar phrase found as a qualification to most all favorable opinions. That phrase is, "In my opinion the program has had favorable results, although exact standards by which the program can be valued are lacking." By "exact standards", it was meant precise, reliable statistical data. With this in mind, then, there will be presented only a few of such opinions which in the writer's viewpoint are the most reliable. Some are personal, others groupal and some rather broad and general in nature. They were not however selected in any attempt to slant the evaluation being presented here.

Two Federal Reserve Bank Presidents. Delos C. Johns, of St. Louis, a President of the Federal Reserve Bank has given his personal opinion as to the effectiveness of the VCRP as follows:

> The voluntary credit-restraint program has been taken quite seriously in the eighth Federal Reserve District..... ....it is not possible to measure precisely what the program has accomplished in the eighth district. It is

noteworthy, however, that total loans at all member banks in the district rose just $86 million from the end of May 1951 to the end of October 1951, as compared with an increase of $276 million in the like period of 1950, and a 3 year (1947-49) average gain for the same period of $146 million.

It is also noteworthy that the record of business-loan changes at large district banks indicates some channeling of credit to defense activities and away from non-defense activities. In the 5 months (June-November 1951) new credits for defense contracts at these banks totaled $16 million and for defense-supporting activities totaled $31 million. In the same period the net increase in outstanding business loans of these banks to all non-defense activities was just $56 million (less than expected on seasonal grounds.) While the defense loan figure is not large, it should be recognized that defense contracts in this district have lagged behind the amount that might have been expected given the district's proportion of national industrial capacity.[9]

Another personal opinion of a Federal Reserve Bank president is that of Ray M. Gidney:

....I believe that the voluntary credit-restraint program has made a really significant contribution to economic stability. The program is collateral to other anti-inflationary actions and depends on voluntary and enthusiastic support of lenders. This suggests certain limitations on its use. Lenders must be satisifed that genuine efforts by monetary, fiscal, and debt-management authorities in particular, and all agencies of the Government generally, are being made to mitigate inflationary forces as much as possible and to cope with them where they exist. Relying as the program does, in large part, on enthusiasm and patriotic appeal, it cannot be long sustained in the face of policies which do not support the efforts of the participants.[10]

Board of Governors. The Patman Subcommittee has obtained the joint opinion of the Board of Governors as to the role of the VCRP under four different conditions:

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[9] Senate Document, No. 123, Part 2, pp. 735-736.

[10] *Ibid.*, p. 717.

(a) when the Treasury is not expected to be a large borrower in the foreseeable future; (b) when a large volume of Treasury refunding operations will have to be effected in the foreseeable future; (c) when it is expected that the Treasury will be a large net borrower during the foreseeable future; and (d) under conditions of total war.

Given below is the Board of Governors' reply to this question:

> If a voluntary program of credit restraint is to be undertaken with chance of widespread acceptance and support on the part of lenders, several basic conditions in the economy would seem to be required: (a) a highly inflationary condition evidenced by a fairly sharp increase in commodity prices; (b) widespread and growing speculative fever; (c) rapid expansion of private credit; and (d) vigorous use of general credit restraints, supplemented by use of selective credit regulation in those specific areas where experience shows such regulation can be effective. Under this combination of circumstances, the dangers of inflation and the need for restraining the growth of credit can be set forth with sufficient directness and force to engender a substantial willingness to cooperate on the part of lending institutions. In the absence of these conditions, it is likely to be difficult to arouse widespread interest among the financial community and to enlist the real measure of general acceptance and support without which a voluntary effort will not achieve substantial success. These basic conditions were present in the months following the outbreak of the Korean war and doubtless contributed to the achievements of the Voluntary Credit Restraint Program.
>
> Price and credit developments in the economy, rather than the Treasury fiscal outlook, are thus the real benchmarks for appraising the need for a voluntary effort at credit restraint. As was the case in the second half of 1950, highly inflationary conditions may develop in the economy in the face of a balanced budget. Thus, even under conditions when the outlook may be for no significant amount of new Treasury borrowing, there may be an important role to be played by a voluntary program of credit restraint. On the other hand, given the same Treasury outlook, conditions in the price and credit sectors of the economy may evidence no significant upward trend of prices and no rapid expansion of credit, and hence little reason for attempting to curtail credit expansion.
>
> The appropriateness of a program of voluntary credit restraint under conditions when the Treasury is facing

substantial requirements for new money would likewise depend upon underlying conditions in the economy. If the large Treasury deficit arises out of substantial unemployment or reflects a conscious effort on the part of the authorities to resuscitate the economy through deficit spending, a program of credit restraint aimed at curbing the expansion of private credit would obviously run counter to the objectives of governmental policy. Given these basic conditions in the economy, the need might well be envisaged in terms of credit expansion and the encouragement of spending, rather than the reverse.

The prospect of large Treasury deficits in the midst of practically full utilization of resources of plant capacity and labor and reflecting a substantial increase in the level of Government spending, especially on armament, poses an entirely different set of problems. Under these conditions, governmental policy should be designed to limit credit expansion, to channel credit into necessary uses, and to direct credit away from nonessential purposes - all of which are the underlying objective of the Program for Voluntary Credit Restraint. Such a program could assist and supplement other anti-inflation policies.

Under the conditions likely to prevail in the world for some time to come, a prospective large Treasury demand for new money enhances the possibility of a resurgence of inflationary pressures. It also poses for the governmental authorities the problem of maintaining a market situation conducive to the sale of Government securities without creating an environment favorable to the rapid and easy expansion of private credit. Faced with these prospects, it would seem appropriate to have available some program of voluntary credit restraint; such a program could be of help to the fiscal and monetary authorities in coping with their vexing problems. To the extent that the expansion of private credit is voluntarily restrained, more funds will be available for investment in Government securities on the part of savings institutions. Also, restraint in lending will mean less liquidation of Government obligations by bank and nonbank holders in an effort to build up their lending power. In turn, this assists the Treasury in its financing operations and the Federal Reserve System in its use of general credit and monetary measures.

Under conditions of total war, there would be a pressing need to channel all available resources of men, machines, materials, and credit into war and essential civilian activities. Strenuous measures would be required to minimize the upward pressure on prices and to curb the expansion of credit. Substantial reliance would be placed upon direct controls over manpower, materials, inventories, construction, and other forms of capital investment and upon the use of credit for selected purposes. Even with these comprehensive direct controls, however, underlying inflationary pressures would be very strong and the problem of inflation would be so serious as to warrant the use of many and varied instruments of economic and credit control. Under these conditions a program of voluntary credit restraint would be an appropriate and useful supplementary measure, limiting the use of credit to essential purposes would help to curb the upward pressure on the prices of scarce resources and would help to increase the effectiveness of other restrictive measures.

Experience with the Program shows that two related observations deserve special emphasis. The first is that a program of voluntary credit restraint is most useful only under conditions of pronounced inflationary pressure which reflect a large defense program, war, or similar emergency conditions. Under more normal situations reliance should be confined to the use of other credit instruments, especially general credit measures.

The second conclusion is that if a voluntary program is to be of real effectiveness, it must be used in conjunction with other restrictive credit policies of both a general and selective character. A voluntary program is not a panacea, nor will its contribution be of much significance unless it is so supported. A restrictive general credit policy is necessary to establish an environment and set of conditions under which financial managements will have less desire to pursue aggressive lending policies. Also, selective credit controls, in the limited areas in which their use is appropriate, help to keep the objectives of a voluntary credit program within feasible scope. Given these conditions, a program of voluntary credit restraint can make a unique contribution to the objectives of over-all credit restraint by helping to channel available credit into defense and other essential activities.[11]

Federal Reserve Bank Presidents. The Patman Subcommittee also put before the presidents of the Federal Reserve Banks the same question that was asked of the Board of Governors, that is, to evaluate the role of the VCRP under the four conditions involved in that question. Their joint reply is presented below:

The voluntary credit-restraint program is another of the types of credit control that should be considered as supplementary to the basic general credit and monetary measures.....

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[11]Senate Document, No. 123, Part 1, pp. 448-450.

If the Treasury is not to be a large borrower in the market in the foreseeable future and if other forces influencing the market are not such as to bring about an over-all inflationary situation, it might be assumed that general credit and monetary measures were satisfactorily effective, and the importance of the voluntary credit-restraint program as a restrictive measure would be relatively small. Under such conditions it could be assumed that banks were extending credit in such a manner as not to induce inflationary or speculative developments.

If Treasury financing operations were of an inflationary character, and if general credit and monetary measures were exerting an effective restraint upon the over-all availability of credit, the importance of a voluntary credit-restraint program would be increased because it would provide guidance to banks for the allocation of that limited credit supply in the national interest. The applicability and the role of the voluntary credit-restraint program cannot be tied exclusively to Treasury financing operations but should be related to the full set of inflationary forces influencing the market and their strength. Moreover, in view of the wholly voluntary character of this program, a reasonably effective general credit and monetary policy probably is necessary to assure its successful operation.

The applicability and the role of the voluntary credit-restraint program and the organization that has been set up to administer that program might become very important under conditions of total war. If under these conditions it was decided that credit rationing was necessary, as a supplement to the general credit and monetary measures, it could be administered much more efficiently, with less inflexibility and less inequity, through existing groups such as the national and regional voluntary credit-restraint committees than through a centralized governmental body, assuming that the authority granted to the committees - appropriately supervised - and the governmental agency was the same. In other words, if additional authority were given to the voluntary credit-restraint committees in the event of total war, these committees, with such modifications and additions as might prove necessary, should be able to serve effectively in directing the degree of credit rationing that might feasibly be imposed on the banking system.[12]

Commercial Banks. In a questionnaire sent to a sample of 800 banks by the Patman Subcommittee requesting a discussion of the factors which contributed to the changes in their

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[12]Senate Document, No. 123, Part 2, pp. 716-717.

investment and lending policies, and their evaluation of the relative importance of each factor, special consideration was requested for the following factors: (a) Increases in short-term interest rates, (b) declines in prices of long-term Government loans, (c) increases in reserve requirements around the turn of the year, (d) moral suasion (including the voluntary credit restraint program), (e) changes in prices and in the business outlook. Replies were received in all from 208 separate institutions. After the replies were collated by the Patman Subcommittee staff, the following summation was given:

> The factor rated most influential in the largest number of replies susceptible to specific tabulation was the voluntary credit restraint program. Most bankers stated that they approved of this program and that they were complying with it fully. Many stated, however, that their lending policies were sufficiently conservative so that their loans all fell within the range of the voluntary credit restraint program in any event. (In some such cases there may have been a failure to realize the potential differences in criteria for the evaluation of loans on the basis of their individual soundness as compared with that of their conformity to the voluntary credit restraint program.)[13]

The second factor rated as next in influence was, changes in prices and in the business outlook; third, increases in short-term interest rates; fourth, declines in the long-term prices of Government securities and last, that changes in reserve requirements had only a negligible influence.[14]

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[13]<u>Ibid</u>., p. 1148.

[14]<u>Ibid</u>., p. 1149.

The writer feels that some comment should be made upon this survey of the commercial bankers' evaluation of the VCRP. The placing of the Voluntary Credit Restraint Program first as the most important force which brought about changes in commercial bank lending and investing policies ahead of the stronger influences leaves a student of economics skeptical of the merits of this sample of opinion. It will be noticed that the increase in the reserve requirements which occurred in January, 1951, was given the last position. It is true that excess reserves held by the commercial banks had been built up in early January, 1951, but nevertheless, a control as strong as an increase in the reserve requirements would appear to have received a higher position in relation to the weaker types of credit control. This is not to say that there was any deliberate attempt to falsify the veracity of the replies, but it is certainly evident that the commercial bankers were striving for the weaker types of control vis a vis the stronger, centrally controlled means of fighting inflation. A policy for which they can usually always be relied upon to espouse.

Insurance Company Executives. In the sphere of life insurance companies, the Patman Subcommittee has turned up some interesting data concerning the effect of the VCRP upon their financial policies and the inflation situation in general. Questions were submitted to 42 life insurance company executives. Replies were received from 38. These executives were asked to describe the changes, if any, in their policies with respect to holdings of United States securities, corporate securities and mortgages since June, 1950. They were asked:

> If your policy during this period has changed, evaluate roughly the relative importance of (a) changes in the relative attractiveness as investments of the different classes of securities, (b) changed Federal regulations with respect to mortgages, (c) moral suasion, directly or indirectly, by the Federal Reserve System (including the voluntary credit restraint program), (d) the emergency of potential capital losses on United States securities in your portfolio, and (e) other factors, in bringing about the change in policy.[15]

The summary by the subcommittee staff revealed that: Most company executives replied that no change had occurred in their general investment policy from June, 1950, to the time this sample was taken. By this, they meant that no change had occurred in their over-all policy. Several stated that April, 1951, was more significant than June, 1950. From June, 1950, to April, 1951, they had been disposing of Government securities because, (1) a more attractive return could be obtained on other securities and (2) they were disposing of Government's in order to meet industrial expansion under the defense program because a backlog of mortgage commitments caused many to dispose of these securities in the second half of 1950 and early 1951. The significance of the April, 1951, date was the Treasury-Federal Reserve accord which caused a reluctance to incur the capital losses which would have been involved in further sales.[16]

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[15]<u>Ibid</u>., pp. 1234-1235.

[16]<u>Ibid</u>.

In reply to inquiries about the VCRP, all companies indicated they had cooperated fully with the program and thought that it had been a genuine aid in combating inflation. Several pointed out that they had frequently rejected loans as not in compliance with the program. "However, several companies noted that, despite general compliance with the program, it has had little effect on their investments because the supply of investment outlets which are in accord with the program has been adequate to meet their needs."[17] In other words, the insurance companies had not been under pressure to force violation of the program.

Council of Economic Advisers. The Council of Economic Advisers to the President was also called into the picture to give their estimate of the worth of the VCRP. The Patman Subcommmittee asked the CEA to "discuss and evaluate the Voluntary Credit Restraint Program which was initiated in the spring of 1951."[18] The Council's reply was that it was difficult to evaluate in quantitative terms this program's worth, and that while the rate of loans has been lower since initiation of the program than during the previous comparable year, it was impossible to measure specific contributions. The period the program became effective -

> was the period during which a substantial change in inventory accumulation took place. The first 12 months

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[17] *Ibid.*, p. 1237.

[18] *Ibid.*, p. 868.

after the Korean attack was for the most part a period of rapid inventory accumulation which slowed down substantially during the second half of 1951. What happened to bank loans during the last six months of 1951 was probably more the result than the cause of the change in inventory accumulation, in view of the softening of retail markets that developed. Nevertheless, there seems to be general agreement among observers that the Voluntary Credit Restraint Program has made lenders and borrowers aware of the desirability of restraint, and it seems to be a fair guess that without that program there would have been greater loan expansion.[19]

The CEA went on to state that:

The Federal Reserve System has instituted a reporting system which shows changes in commercial and industrial loans on a sample basis, broken down by the purposes for which the borrower uses the money. For 7 months through October 31, 1951, loans for defense contracts were expanded by about $550 million; for defense-supporting activities, by $620 million. The aggregate net increase in classified loans extended by banks included in the sample amounted to $1,900 million. Of this increase, approximately 29 percent was for purposes of financing defense contracts; 32 percent for financing defense-supporting activities; 39 percent for financing nondefense activities. Net loans extended to commodity dealers were reduced by $27 million during this period. The fact that more than one-third of the increase in total loans was for nondefense purposes, and that loans to commodity dealers were again on the rise, is undoubtedly in large part a reflection of the normal seasonal increase in the demand for credit and not an indication of the failure of the Voluntary Credit Restraint Program.[20]

More will be said about this particular statistical sample later in this chapter. Concluding the Council of Economic Advisers remarked:

Summing up the achievements and the limitations of the Voluntary Credit Restraint Program, we believe--although we cannot offer quantitative proof--that the program has contributed to holding down bank loan

[19] Ibid.

[20] Ibid.

> expansion and, to some extent, to diverting funds from less essential to more essential usage. But we do not believe that any voluntary program could be heavily relied on to be sufficiently effective if the pressures for credit expansion should assume much larger proportions over a prolonged period. As previously indicated, the effectiveness of the program to some extent depends on supplementary measures for more effective general control, continuing measures of mandatory selective control such as those related to real estate and consumer installment credit.
>
> While we feel it is our duty to point out the limitations of the program, we do not wish to underrate either the patriotic spirit of cooperation with which the program is being carried forward, or the present usefulness of the program.[21]

There will be no over-all refutation of these opinions presented here, although some appear to be open to rebuttal. They were presented in the light of giving various viewpoints from sectors which were closely connected with the VCRP and which had the opportunity of observing the voluntary curb at first hand. The opinions are open to criticism on the grounds of being prejudicial; the writer makes no attempt to cover this fact. Reason for the lack of a more comprehensive coverage of opinions is due to the absence of this voluntary technique from discussion in the journals of political economy.

### 4. Statistical Data

In the use of statistical data as reinforcements behind the foregoing opinions and as evidence in themselves, the same qualifications and conditions must be kept in mind in relation to statistical evidence as those pointed out earlier in this chapter when the subject of an evaluation was first approached.

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[21] Ibid., pp. 870-871.

Life Insurance Companies. The Life Insurance Association of America has compiled an interesting table of data which directly bears upon this evaluation. These data are presented in Table VIII. From this, drawn from reports submitted by 45 life insurance companies whose combined assets represented 85 percent of all life insurance company assets, it can be ascertained that the VCRP had a salutary effect on the outstanding commitments of the life insurance companies. It should also be kept in mind that this program did not interfere with "the sanctity of contract" doctrine. That is, there was no attempt to reduce the size of commitments outstanding made prior to the initation of the program for which the insurance firms had made contracts to supply investment funds. Reductions in commitments and the allocation of credit from nondefense industries to defense and defense supporting industries was confined to future transactions. Because of this position, the past commitments of these life insurance companies could not be drastically reduced. If this reduction had been allowed, because of the disregard of "the sanctity of contract" doctrine, this would have made the VCRP more effective as an inflation controlling device. But in actuality, the reductions in commitments for nonessential purposes and the increase in commitments for essential purposes had to be confined to future financing which did not involve the doctrine of "the sanctity of contract." The working off of past inventory commitments and the allocation of new credit into essential and nonessential purposes proved to be a slow process.

TABLE VIII

OUTSTANDING COMMITMENTS OF LIFE INSURANCE COMPANIES TO ACQUIRE LOANS AND INVESTMENTS FOR DEFENSE AND NON-DEFENSE PURPOSES[1]

(In millions of dollars)

| End of month | Total | Defense and Defense Supporting | | | |
|---|---|---|---|---|---|
| | | Total | Public Utility | Rail-road | Other Business and Industry |
| 1951- | | | | | |
| April[3] | 4,504 | 1,687 | 383 | 300 | 1,005 |
| May[3] | 4,331 | 1,677 | 450 | 298 | 928 |
| June[3] | 4,197 | 1,760 | 446 | 309 | 1,005 |
| July[3] | 4,055 | 1,757 | 450 | 297 | 1,011 |
| August[3] | 3,749 | 1,642 | 409 | 286 | 947 |
| September | 3,928 | 1,706 | 407 | 236 | 1,063 |
| October | 4,037 | 1,867 | 395 | 204 | 1,268 |
| November | 4,394 | 2,112 | 353 | 192 | 1,567 |
| December | 4,175 | 2,019 | 310 | 170 | 1,539 |
| 1952- | | | | | |
| January | 4,144 | 1,983 | 302 | 137 | 1,544 |
| February | 4,101 | 2,111 | 419 | 158 | 1,534 |
| March | 4,090 | 2,211 | 508 | 144 | 1,559 |
| April | 4,157 | 2,181 | 512 | 158 | 1,511 |

(continued on next page)

TABLE VIII (continued)

| | | Non-Defense | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | | To others, on real estate mortgages | | | | | | | |
| | | | Non-Farm Residential | | | | | | |
| Total | To Business & Industry | Farm | Total | V.A. Guaranteed | F.H.A. Insured | Conventional | State, County, & Municipal | Ratio of Non-defense to defense and defense supporting[2] |
| 2,709 | 963 | 99 | 1,648 | 650 | 649 | 349 | 108 | 1.6:1 |
| 2,564 | 937 | 88 | 1,539 | 577 | 619 | 342 | 91 | 1.5:1 |
| 2,362 | 831 | 83 | 1,447 | 531 | 594 | 322 | 76 | 1.3:1 |
| 2,221 | 752 | 80 | 1,390 | 484 | 566 | 340 | 77 | 1.2:1 |
| 2,053 | 744 | 80 | 1,229 | 402 | 509 | 317 | 54 | 1.3:1 |
| 2,163 | 918 | 83 | 1,162 | 365 | 490 | 307 | 59 | 1.3:1 |
| 2,119 | 945 | 96 | 1,078 | 316 | 452 | 310 | 51 | 1.1:1 |
| 2,238 | 955 | 98 | 1,186 | 276 | 437 | 473 | 44 | 1.1:1 |
| 2,111 | 1007 | 107 | 997 | 270 | 417 | 311 | 44 | 1.1:1 |
| 2,114 | 1053 | 99 | 962 | 257 | 409 | 295 | 46 | 1.1:1 |
| 1,937 | 969 | 102 | 866 | 222 | 346 | 298 | 54 | .91:1 |
| 1,842 | 901 | 88 | 852 | 205 | 332 | 315 | 37 | .82:1 |
| 1,946 | 980 | 85 | 881 | 200 | 352 | 329 | 31 | .91:1 |

[1]Note - Data for 45 companies, which account for 85 percent of the assets of all U.S. life insurance companies; they were initiated by the Life Insurance Association of America in accordance with the Program for Voluntary Credit Restraint.

[2]Column computed and included by the writer.

[3]Excludes business mortgage loans of less than $100,000 each and foreign investments which were not reported until September, 1951.

Source: Federal Reserve Bulletin

As seen from Table VIII, total outstanding commitments in April, 1951, were approximately 4.5 billion dollars. Of this amount about 1.7 billion dollars was classfied as defense and defense supporting, 2.7 billion dollars as non-defense and .1 billion dollars for State, county and municipal governments. Non-defense to defense and defense supporting commitments were in the ratio of 1.6 to 1. By October, 1951, when total outstanding commitments had declined to 4.1 billion dollars, total defense and defense supporting commitments had increased to 1.9 billion dollars, while total non-defense commitments had declined to 2.1 billion dollars. The ratio of non-defense to defense and defense supporting commitments had fallen to 1.1 to 1. In March of 1952, when total outstanding commitments had leveled off at approximately 4.1 billion dollars, total defense and defense supporting commitments had increased to 2.2 billion dollars, while total non-defense commitments were down to 1.8 billion dollars. The ratio of non-defense to defense and defense supporting commitments had reached a low of .82 to 1. In other words, defense commitments were greater than non-defense commitments, but only after the passage of a 10 month period. Whether all of this shift in the outstanding commitments of this sample of 45 life insurance companies from nonessential uses to essential uses can be credited to the VCRP is still a moot question, since in the light of the above opinions of certain insurance company executives that the insurance firms were finding all the outlets they needed for the funds they held without the

VCRP's influence. But surely, some of the credit can go to that technique of defense effort promotion and inflation control. As to how much credit was directed to useful purposes by that tool, it is impossible to say precisely.

In the matter of commitments to State and local governments, Table VIII shows that the commitments to these governmental bodies declined steadily from a high of 108 million dollars in April, 1951, to a low in April, 1952, of 31 million dollars. But the data for these commitments to governments are not broken down into the defense and non-defense categories, leaving the question of the VCRP's effectiveness up in the air insofar as this area of finance is concerned. Another interesting facet found in this table is that the V.A. guaranteed and F.H.A. insured commitments declined by roughly two-thirds and one-half respectively. This is the area where the private and public financial agencies had clashed and a great amount of friction had been generated under the VCRP.

<u>Commercial Banks</u>. A second statistical table, Table IX, has been offered as evidence in the evaluation of the VCRP, this time by the commercial banking sphere of finance. This table is a sample taken from 220 weekly reporting member banks, which held about 95 percent of the total commercial and industrial loans of all weekly reporting member banks and about 70 percent of those of all commercial banks. The table reveals the changes in these loans by purpose and by classified industry.

TABLE IX

CHANGES IN COMMERCIAL AND INDUSTRIAL LOANS[1]
(IN MILLIONS OF DOLLARS)
(- INDICATES NET DECREASE)

| Time Period | Business of the Borrower: Manufacturing and Mining: Food, Liquor & Tobacco | Textiles Apparel & Leather | Metal & Metal Prods. | Petroleum Chemicals Coal and Rubber | Other | Trade Whsle. and Retail | Commodity Dealers |
|---|---|---|---|---|---|---|---|
| 1951- April to June | -243 | 116 | 275 | 48 | 60 | 62 | -421 |
| July to Dec. | 932 | -361 | 873 | 125 | 141 | 16 | 722 |
| 1952- Jan. to Mar. | -422 | 17 | 949 | 192 | 56 | -124 | -333 |

| Business of Borrower (cont'd.): Sales Finance Companies | Public Util. (incl. transp.) | Con-struction and other | Net Changes Classi-fied | Purpose of Loans: Defense & Defense Support-ing | Non-Defense | Net changes Classified |
|---|---|---|---|---|---|---|
| 63 | 175 | 52 | 186 | 399 | -56 | 343 |
| 30 | 351 | -61 | 2769 | 1131 | 1641 | 2773 |
| -325 | -8 | -74 | -74 | 607 | -680 | -74 |

[1]Sample includes about 220 weekly reporting member banks, which hold about 95 percent of total commercial and industrial loans of all weekly reporting banks and about 70 percent of those of all commercial banks.

Source: Federal Reserve Bulletin

Not much can be drawn from the breakdown of loans into various classifications by industries since the classification is too general. If the classifications had been in greater detail, then, it would have been easier to distinguish between which loans were essential and which were not, thus giving a closer indication as to the effectiveness of the VCRP in this sphere of finance. As the table is presented, the breakdown is already given, thus it has to be assumed that the classifications between defense and non-defense loans were made correctly. Concentrating on the "Purpose of loans" section of Table IX, it is seen that there was a decline in non-defense commercial and industrial loans of 56 million dollars outstanding, while defense and defense supporting loans increased 399 million dollars from April to June, 1951. This would indicate an initial success for the VCRP. But the figures from July to December of that same year dampen the enthusiasm behind these initial plaudits for the voluntary action program. From July to December, it is seen that the defense and defense supporting commercial and industrial loans increased by 1,131 million dollars, but in this same period non-defense loans increased by 1,641 million dollars. This time period, July to December, 1951, covered what some observers felt would reveal the true effectiveness of the VCRP and present this program with its first true test.

Business Week stated in September, 1951, that the tough test was then on for the VCRP. It pointed up the fact that bank loans to business did level out after mid-March, 1951, but were now on the upgrade. That in March, the program went into effect at the time of the Federal Reserve-Treasury accord; that in March, consumer buying had tapered off and that "....a slight but noticeable recession was found in many industries with inventories in those fields beginning to look top-heavy."[22] It went on to say:

> So these factors make the August-September upswing in business loans....look more and more like VCR's first major test.
>
> The national committee of the VCR has been keeping tabs on the loan portfolios of a large sampling of big national banks. It is breaking these loans down by purpose and by type of business. Latest figures show that nondefense loans are building up at a faster pace.
>
> In the New York area, first to be heard from for the week ended September 12, business loans of all types increased faster than in any week since last February. And it is estimated that about two-thirds of these are for nondefense purposes.[23]

Business Week went on to raise several questions:

> Is this advance in nondefense loans more than seasonal - in other words, has inflation of bank credit started again? People at the Federal Reserve, who are in the best position to know, get evasive when you press them on this point. There's a feeling that their seasonal adjustment factors - and everyone else's - aren't very good.
>
> VCR has been fairly easy to carry out as long as the heat was off. But what happens when U.S. businessmen begin feeling that their inventories are too small and start going again to their bankers for loans to increase inventory? What will the bankers say when their good customers want to buy materials on a big scale to stock up against future shortages?[24]

It appears that the answers to these questions lie in the fact that in the second half of 1951 non-defense loans,

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[22]"New Loan Rise Tests Credit Restraint." Business Week, September 22, 1951, pp. 148-150.

[23]Ibid.

[24]Ibid.

as classified by the commercial banks, made a tremendous increase in the face of the VCRP, after previously having declined in early 1951. This was a blow to the foundation of this self-restraining method of fighting inflation. But in the next period, January to March, 1952, non-defense loans declined by 680 million dollars enough to offset the increase in defense loans of 607 million dollars by 73 million dollars, reducing the pressures on credit expansion and in turn inflationary pressures. These violent and erratic fluctuations in the quantity of the outstanding non-defense loans of this sample could have been due to seasonal causes, but they more vividly point to the further difficulty of arriving at an evaluation of this program.

Investment Banks. The third important financial group, the investment bankers who played an important role under the Voluntary Credit Restraint Program, has offered something in the way of statistical evidence which is intended to cast more favorable light upon the success of the VCRP. Table X, offered as evidence, is rather sketchy, as much of the data have been which dealt with this credit control tool. It covers the time period, March to November 15, 1951, thus not taking into account the last five months of the existence of the voluntary credit curb. The table is designed to point out the number and dollar amounts of loans screened and the disposition of such cases under the principles of the VCRP.

Of the 1,321 loan applications screened by the four regional committees representing the investment banking

TABLE X

REGIONAL COMMITTEE SCREENINGS OF INVESTMENT BANKS
(MARCH TO NOVEMBER 15, 1951)

| District | No. of Loan Applications Screened | Total in Millions | No. of Loans Deferred | Total Deferred in Millions | No. of Loans Approved | Total Approved in Millions |
|---|---|---|---|---|---|---|
| Mid-western | 456 | $574 | 35 | $74 | 421 | $450 |
| San Francisco | 64 | 371 | 0* | 72 | 64 | 299 |
| Dallas | 330 | 170 | 23 | 68 | 307 | 152 |
| New York | 471 | 1,704 | 8 | 104 | 463 | 1,600 |
| Total | 1,321 | $2,819 | 66 | $318 | 1,255 | $2,501 |

*Reductions

Source: Rudolf Smutny, "Investment Banking and the Credit Restraint Program." Commercial and Financial Chroncile, 174:21, December 6, 1951.

financial field only 66 were deferred. This is roughly 5 percent of the total number screened. In dollar amounts, the total number of loans screened in this time period was valued at 2,819 million dollars; the 66 deferred loans had a dollar value of 318 million dollars. The percentage of deferred applications of total loans screened in dollar value was 11 percent, somewhat of an improvement over the percentage of deferred applications to total screenings on the numerical basis. But still, the statistical data are too sketchy and fuzzy to allow any weight to be attached to their significant bearing on the evaluation under study here.

Summary of the Statistical Data. The above empirical arguments presented by the three principal financial groups which found themselves laboring under the VCRP ought not to be taken at face value. First, it must be remembered that there was no quantitative manner of determining after a loan application had been turned down either by the National or regional committees, whether the financial institution or the potential borrower actually complied with the requests of these screening groups. Second, there was no means of determining whether the classifications between essential and non-essential purposes for loan proceeds were determined on an accurate basis; it can only be assumed that this task was performed in good faith. Third, there was no way of determining statistically what would have occurred in the sphere of inflation if the voluntary controls had not been imposed. Because of this consideration there is no base or norm to which this self-restraining control can be compared to determine its effectiveness. Fourth and last, there were no statistical data as to the number of loans "nipped in the bud." By this, it is meant that there was no quantitative evidence as to the amount of credit expansion prevented because of the psychological and educational influences of the program which reduced certain demands for credit on the initiative of potential borrowers.

## 5. Writer's General Conclusion

In summing up it is found that one of the first important conclusions to be derived from the foregoing discussion is that there cannot be drawn any definite conclusions regarding the evaluation of a voluntary program of this type or one with similar characteristics. It has been shown why this program has been difficult to evaluate. The factors creating the difficulty were the inherent qualitative characteristic of the voluntary program; the fact that the program had no quantitative maximum ceilings as guides in restraining the amount of credit expansion; the fact that there was a multiplicity of other credit control tools operating simultaneously with the VCRP and the fact that the economy was still basically a civilian economy as opposed to a war economy. The Treasury-Federal Reserve accord played an anti-inflationary role in the economy, but the fact that the accord was reached in the same month that the VCRP was launched made for further difficulty in the evaluation of the latter anti-inflation step.

A second important conclusion is the pointing up of certain general economic conditions and characteristics of the program itself which either complemented and facilitated the work of the voluntary curb or had the opposite effects of making the task of that program difficult to pursue. Among the former are: (a) the condition that the VCRP was more effective in a credit inflation than in an inflation arising from other causes; this was true of the Korean upward price spiral, (b) that there must exist no privileged immunity for special groups; this was true of the VCRP until its later phases when failure to follow this principle was one of the factors which led to its downfall, and (c) that the VCRP was only a supplemental device to the other general and selective credit curbs. It was not intended and could not be expected to stand alone against the forces of inflation. Among the latter general economic conditions and characteristics of the program which greatly inhibited the effectiveness of the VCRP are: (a) the fact that the American economy was and still is characterized by a multiplicity of financial institutions; this characteristic greatly reduced the value of this voluntary scheme, (b) that there must be no delay in placing the program into effect; the failure to comply with this principle reduced its effectiveness and (c) that the business institutions of the economy were and still are typified by a trend to internal sources of funds for investment purposes. Since the VCRP was basically a tool of inflation control in the area of external sources for investment funds, this characteristic of American business greatly reduced this technique's ability to stamp out the fires of inflation.

Also certain general advantages and disadvantages were expounded upon in the evaluation, and of course, numerous personal and groupal opinions were considered.

Last of all, certain statistical samples were turned to for fortification in the evaluation, but this method of scientific inquiry and analysis proved to be of very little value and strength in arriving at a definite and accurate conclusion.

In general then, if this writer must state his opinion along these lines; he does so with great reluctance. Not because he does not want to make his opinion known, but for the reason that there are no specific quantitative grounds upon which to base such personal opinions. He takes the position that the Voluntary Credit Restraint Program made only a qualified mediocre contribution to the struggle against the Korean inflation. One reason for holding this position is that the inflationary forces had practically run their course by the time the VCRP got under way. From Table I of Chapter II, it will be seen that wholesale prices had reached their peak at the time the VCRP was introduced and from then on continued a steady downward trend. Some may attempt to attribute this downward trend to this voluntary program, but that would be a shaky position to hold in view of the other factors pointed to many times previously in this paper. The consumer's index found in Table III, Chapter II, leads one to a similar conclusion. Although this index continued to rise after March, 1951, the upward movement in prices was more of the "creeping" type of inflation, which is not too susceptible to the influence of the VCRP, rather than the hyper-inflation that was characteristic of the inflation in the immediate six months after June, 1950.

It has been pointed out that the program was still administratively and jurisdictionally entangled in confusion until the last quarter of 1951. Certain administrative kinks were still being ironed out at that time. The West Virginia bonus case, although only a single incident, was a great defeat for the VCRP, for it revealed the utter futility of such a program when the cards are stacked against it. The fact that when the going got rough, as with the issuance of Bulletin No. 4 dealing in the area of real estate credit, instead of tightening the requirements, as might have been done in the use of other tools, the only avenue open to the National Committee of the Voluntary Credit Restraint Program was to loosen the requirements in order to prevent an increased disregard for the program and its purposes. The voluntary nature of the program per se and its basic characteristic of requesting financial institutions and individuals to control the enhancement in their profits and economic incentives and, in turn, their personal economic ameliorations; all add up to a doubt as to the success of the VCRP in the mind of any individual who has considered this type of credit control program from its many facets. Also, the absence of any precise quantitative conclusions that would tend to indicate that the program was a success, again, convince the writer that the VCRP resulted in a mediocre accomplishment.

Finally, asking the American people, and especially those public officials whose duty it is to protect the standard of living of the American public from the degradations of inflation, to place their faith in an inflation controlling mechanism for which there were no means of determining the effectiveness of such a device either while it was in effect or after the evils of inflation had subsided, may be asking too much of blind faith.

It would be like asking a blind man to perform a new and unexplored task. He would eventually learn and accomplish the task, but only after trial and error; learning at the expense of time, manpower and resources. It would be better to call upon a man with sight who could accomplish the task more quickly and efficiently. This does not mean that the man with sight is perfect. We know, however, that one characteristic of life is the quest for perfection, but in moving toward that goal, it is a problem of equating the more effective against the less effective or a problem of relativity.

Thus, the American people should place their economic well-being in the more reliable tools of inflation control and allow the less reliable techniques to remain as examples of failures remembered only in economic history.

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